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No. 06-1050

IN THE

Supreme Court of the United States

ALLSTATE INSURANCE COMPANY and
STERLING COLLISION CENTERS, INC.,
Petitioners,

v.

GREGG ABBOTT,
in his Official Capacity as Attorney General of Texas, and
SUSAN COMBS,
in her Official Capacity as Texas Comptroller of Public Accounts,
Respondents,

v.

AUTOMOTIVE SERVICE ASSOCIATION and
CONSUMER CHOICE IN AUTOBODY REPAIR,
Respondents/Intervenors.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This case presents a well-developed factual record and clearly-formed legal issues, allowing the Court to eliminate a widening circuit conflict over the Dormant Commerce Clause's prohibition against local economic protectionist state legislation. Two questions are presented:

1. Whether state law discrimination against an inherently interstate means of doing business (so-called "business form" discrimination) violates this Court's precedents and conflicts with the contrary interpretations of other circuits.

2. Whether the mere articulation of a purportedly legitimate state interest obviates the need for heightened scrutiny of legislation arising from an admittedly local economic protectionist motive under this Court's precedents and conflicts with the contrary interpretations of other circuits.

RULE 14.1 STATEMENT AND CORPORATE DISCLOSURE STATEMENT

The caption of the case contains the names of all parties to the proceeding in the court whose judgment is sought to be reviewed.

The Petitioners in this case (Plaintiffs-Appellants/Cross-Appellees below) are Allstate Insurance Company and Sterling Collision Centers Inc.

Allstate Insurance Company is a Delaware corporation and is a wholly-owned subsidiary of Allstate Corporation. Allstate Corporation is a Delaware public corporation, it has no parent company, and no publicly held corporation owns 10% or more of its stock.

Sterling Collision Centers, Inc. is a Delaware corporation and is a wholly-owned subsidiary of Allstate Non-Insurance Holding Corporation. Allstate-Non-Insurance Holding Corporation is a Delaware corporation and is a wholly-owned subsidiary of Allstate Corporation.

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STATEMENT OF JURISDICTION

This petition seeks review of the judgment of the United States Court of Appeals for the Fifth Circuit, entered on August 1, 2007. The Fifth Circuit denied a petition for rehearing and suggestion for rehearing *en banc* on September 10, 2007. This petition is timely under 28 U.S.C. § 2101(c) and Supreme Court Rule 13.1. This Court has jurisdiction to review the judgment of the Fifth Circuit pursuant to 28 U.S.C. § 1254(1).

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit, dated August 1, 2007, is officially reported at 495 F.3d 151, and is reproduced at App. 1a-33a.

The Judgment and Findings of Fact and Conclusions of Law of the United States District Court for the Northern District of Texas, Dallas Division, dated March 9, 2006, has not been officially or unofficially reported, and is reproduced at App. 34a-108a.

CONSTITUTIONAL AND STATUTORY PROVISIONS

This petition involves the following constitutional and statutory provisions:

The Commerce Clause, U.S. Const., Art. I, § 8: "The Congress shall have Power ... To regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes."

Texas Occupations Code, § 2307.001, *et seq.* (referred to herein as "HB 1131"), the full text of which is reproduced at App. 111a-118a.

STATEMENT OF THE CASE

In 2003, Texas enacted HB 1131, a law specifically designed to protect "our local independent folks back home" from competition with their most significant out-of-state rival. App. 119a (Opening Statement of Representative Flores, House Sponsor for HB 1131). This case challenges the constitutionality of that law.

States are increasingly enacting legislative measures, often referred to as "Anti-Wal-Mart legislation," to prevent innovative, out-of-state competitors from shifting business away from local enterprises. Texas, in particular, has legislatively shuttered its borders against interstate competition in industry after industry. This time, Texas targeted an intrinsically interstate initiative developed to improve the automobile accident repair process.

Texas' parochialism is inimical to the Constitution's creation of our national economic union. Since the Founding, state legislators have been beseeched with calls to protect local constituencies from more efficient out-of-state competitors. The Commerce Clause limits a State's power to do this.

"Preservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 205 (1994). As this Court explained long ago, the "principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control ... the

economy..., has as its corollary that the states are not separable economic units." *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 537-538 (1949).

Applying these principles has proved challenging for the lower courts. They have reached conflicting conclusions regarding the constitutionality of protectionist legislation. Some courts, like the one below, effectively apply the Commerce Clause's limitations only to facially discriminatory measures. In a clear example of this, the Fifth Circuit has fabricated a "business form" test, which permits States purposefully to protect local mom-and-pop autobody repair shops, by targeting the insurer-owned business model created by the petitioning competitors. In contrast, other Courts of Appeals – including the First, Fourth, Seventh and Eighth Circuits – condemn such clearly protectionist state legislation.

This Court's attention is required to resolve this widening conflict. The well-developed factual record here provides an attractive vehicle for the Court to delineate the boundaries of state power to restrain interstate competition for local protectionist purposes.

A. Factual Background

Throughout the 20th Century, automotive collision repair work has been done primarily by local, mom-and-pop body shops. There are tens of thousands of such shops throughout the nation, including approximately 4,600 in Texas. Due to strong barriers to entry, there are "[r]elatively few (about 5)" interstate rivals in Texas, with

petitioners being targeted as by far the most competitively significant. App. 56a.

Recognizing the strides in efficiency achieved by national competitors in other industries (*e.g.*, Wal-Mart, Home Depot, and Staples), the founders of Sterling Collision Centers set out in 1997 to create an interstate network of state-of-the-art facilities to repair vehicles more efficiently and to improve the collision repair experience. Sterling's initial growth, fueled largely through the acquisition of existing ("Brownfield") body shops, was tepid, reflecting the strong barrier to entry – access to cars – that had limited its ability to achieve network economies of scale. App. 45a.

In 2001, Petitioners Allstate and Sterling joined forces to overcome these barriers by creating a nationwide network of new, innovative ("Greenfield") collision repair service centers, with Allstate recommending them to its insureds and claimants. From Allstate's perspective, the acquisition of Sterling provided its customers and claimants with a better – but purely voluntary – collision repair option. Allstate also viewed the acquisition as a means to combat the massive waste and fraud long permeating an industry where the customer did not pay the bill. (90% of all automobile collision repairs are paid for by insurance companies like Allstate.) From Sterling's perspective, Allstate provided the financial support, infrastructure and potential source of repair referrals necessary to build an integrated, interstate network of Greenfield facilities. App. 46a-47a.

For the first 18 months, neither the Texas body shop lobbyists nor Texas legislators raised concerns about Allstate's "insurer-ownership" of Sterling. The climate changed dramatically, however, when word of Sterling's plan to build its first Texas Greenfield facility, in the heart of Dallas, reached a politically well-connected Dallas body shop owner. Upon learning of Sterling's Dallas and other Greenfield network expansion plans, the local body shop owner encouraged his friend and State Senator to protect his profits by legislatively banning "insurer-ownership" of collision repair facilities in Texas. App. 79a.

An intense lobbying effort culminated in HB 1131's passage. As enacted, HB 1131 prohibits Sterling from opening any new facilities in Texas. It also subjects Sterling's then-existing 15 facilities to a strict "Code of Conduct," prohibiting Allstate from investing in, supporting in any way, or even recommending, Sterling's operations.

HB 1131's protectionist purpose permeates the legislative record. Representative Flores, HB 1131's House Sponsor, declared at the introduction of the proposed statute that HB 1131 is designed to "remedy a situation that is occurring in a lot of the major metropolitan areas, which is ... allowing [Allstate's insurer-owned collision repair facilities] to compete with those run by our local independent folks back home." App. 119a. His counterpart, Senator Carona, declared that his goal was to strip away Sterling's "competitive advantage" in any "region" in Texas. App. 125a.

Other legislators similarly revealed HB 1131's protectionist purpose. Representative Homer, demonstrating his "anti-Wal-Mart"-like focus, stated that, "[b]ecause I'm a small businessman ..., there's nothing that angers me more than when the big guy comes in and just ... run[s] you out of town.... It's kind of the *Wal-Mart* scenario." App. 121a (emphasis added). Representative Driver said that "[w]hat concerns [him] is the fact that it would be Allstate competing with the Collision Center or Herb's," the Dallas body shop whose owner initiated the legislation. App. 120a. Representative Wise expressed his concern that Sterling's entry would hurt "the mom-and-pops," stating that Sterling's entry "[o]bviously ... cannot be a satisfactory result for those folks." App. 122a; *see also* App. 6a-7a n.3 (summarizing testimony from legislative hearings).

B. Procedural Background

In August 2003, two days before HB 1131's effective date, Allstate and Sterling filed suit in Dallas County state court challenging the constitutionality of HB 1131. The state defendants timely removed the case to federal district court, thereby waiving any Eleventh Amendment immunity. *Lapides v. Bd. of Regents of Univ. Sys. of Ga.*, 535 U.S. 613 (2002). Allstate and Sterling alleged that HB 1131 (including the prohibition on Sterling's expansion) violated the Dormant Commerce Clause, and that the anti-referral and

anti-advertising restrictions ran afoul of the First Amendment.[1]

After conducting a six-day bench trial, the district court found "the drafting and enactment of HB 1131 was largely spurred by a coalition of small business owners who compete with larger ... chains like Sterling." App. 79a. Although the court concluded that "the purpose of H.B. 1131 was to discriminate between two differing business models – independently-owned autobody repair shops ... versus autobody repair shops owned by" insurers, it nonetheless upheld HB 1131's ban on Sterling's expansion. App. 80a, 86a.

On appeal, the Fifth Circuit acknowledged that HB 1131 was at least partially motivated by local economic protectionist "industry concerns." App. 4a. Invoking this Court's decision in *Exxon v. Maryland*, 437 U.S. 117 (1978), and the Fifth Circuit's prior decisions in *Ford Motor Co. v. Texas Dep't of Transp.*, 264 F.3d 493 (5th Cir. 2001), and *Int'l Truck & Engine Corp. v. Bray*, 372 F.3d 717 (5th Cir. 2004), *opinion corrected on other grounds*, 380 F.3d 231 (5th Cir. 2004), the court upheld HB 1131, saying

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1 The Fifth Circuit affirmed the district court's invalidation of the speech restraints prohibiting Allstate from recommending Sterling, in a portion of the judgment that is not the subject of the current petition.

The district court had removal jurisdiction under 28 U.S.C. § 1331. The Fifth Circuit had appellate jurisdiction under 28 U.S.C. § 1291. The state court had original jurisdiction because (i) the State waived its sovereign immunity pursuant to its Declaratory Judgment Act, *see* TEX. CIV. PRAC. & REM. CODE § 37.004; *Texas Educ. Agency v. Leeper*, 893 S.W.2d 432, 446 (1994); and (ii) the named public official defendants have enforcement authority under H.B. 1131. *See* App. 10a-14a (discussing subject matter jurisdiction).

that such anti-vertical integration statutes are immune from challenge because they discriminate "based not on domicile but on *business form*." App. 18a (emphasis added). The Fifth Circuit subsequently denied a petition for rehearing and rehearing en banc. This petition follows.

REASONS FOR GRANTING THE WRIT

This case provides an appropriate platform for eliminating a widening circuit conflict over state authority to restrain interstate commerce for local economic protectionist purposes. Our Nation was built upon the principle that "every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation." *H.P. Hood*, 336 U.S. at 539. This principle is all the more important in today's global economy. Those who succeed thrive. Those who fail go by the wayside. That is, unless they are lucky enough to do business in the Fifth Circuit. Under the Fifth Circuit's "business form" exception, the free market's losers may seek protection from vigorous interstate competition by obtaining favorable legislation from home-state politicians. This is inimical to our national economic union.

From the Federalist Papers' concern that "domestic manufactures [might] be encouraged ... by restrictions on foreign manufactures," through *Gibbons v. Ogden*, to last Term's decision in *United Haulers*, this Court's Commerce Clause jurisprudence has forbidden local economic protectionism. As this Court explained long-ago, free access to this nation's markets was the "vision of the Founders," and "such has been the doctrine of

this Court which has given it reality." *H.P. Hood*, 336 U.S. at 539.

In adopting its deferential "business form" exception, the Fifth Circuit has brought itself into direct conflict with this Court's decisions and those of other circuits. As demonstrated in Section I, the "business form" exception cannot be reconciled with this Court's admonition that parochial legislation (regardless of form) is "at odds with the general principle that the Commerce Clause prohibits a State from using its regulatory power to protect its own citizens from outside competition." *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 43-44 (1980).

The need for authoritative clarification of the governing Commerce Clause principles is manifest. As demonstrated in Section II, the lower courts have fundamentally divergent views on the permissibility of anti-Wal-Mart-like legislation. Indeed, the lower courts have reached diametrically opposed outcomes on these questions even where the same facts and same parties are involved. *Compare LensCrafters, Inc. v. Robinson*, 403 F.3d 798 (6th Cir. 2005) (upholding restrictions banning eyeglass retailers from offering ophthalmology services), *with Nat'l Ass'n of Optometrists & Opticians v. Lockyer*, 463 F. Supp. 2d 1116 (E.D. Cal. 2006) (rejecting *LensCrafters'* analysis and invalidating similar regulations).

These divergent views, and the conflicting outcomes they beget, will continue until this Court authoritatively speaks in a "business form" case like this one, and resolves the following issues at the root of the lower courts' confusion:

(i) How should courts discern discriminatory legislative intent?

(ii) How much weight should be given to proof of discriminatory effects in the form of legislatively induced business shifting to in-state enterprises and away from their out-of-state competitors?

(iii) What does it mean for in-state and out-of-state businesses to be "similarly situated" for Commerce Clause purposes?

Lower courts urgently need this Court's guidance on these questions – all of which are recurring issues on which lower courts are reaching conflicting results.

I. The Fifth Circuit Has Departed From This Court's Established Commerce Clause Analytical Framework.

The Commerce Clause bars a State from passing laws "whose object is local economic protectionism." *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 390 (1994). To root out this evil, this Court has developed a comprehensive framework, requiring courts to determine whether a statute discriminates (i) on its face, (ii) in its purpose, or (iii) in its effect. "[W]hen a law favors in-state business over out-of-state competition," based on any of these three standards, "rigorous scrutiny applies" to any asserted state justification. *United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 127 S.Ct. 1786, 1795-96 (2007).

The Fifth Circuit below did not follow this Court's established framework. Rather, because the State had admitted below that HB 1131 could not withstand rigorous scrutiny, the Court of Appeals created a safe harbor for "business form" legislation, no matter how discriminatory it might be. Under the Fifth Circuit's approach, heightened judicial scrutiny can be avoided so long as a legislature is artful enough to discriminate "based not on domicile but on business form." App. 18a. Assuming this simple formalism is scrupulously observed, the Fifth Circuit would uphold even statutes effectively eliminating interstate competition, based only on minimal evidence of some legitimate legislative purpose. But inevitably, a claim of consumer protection or some other public-interest rationale can always be devised as cover for an underlying legislative decision to discriminate against interstate competition and commerce. By accepting any articulation of an arguably legitimate rationale as sufficient, the Fifth Circuit's test, as a practical matter, encourages legislative artfulness in devising ingenious – but in reality, pre-textual – justifications. The Fifth Circuit's test means legislatures may always discriminate – so long as they are willing to do so based on "business form" and to disingenuously pepper the record with "legitimate" rationales as fig leaves for their protectionist endeavors.

The Fifth Circuit's effective safe harbor for "business form" *discrimination* conflicts with this Court's decisions for three reasons.

1. The "business form" test confuses facial discrimination with discriminatory purpose and

effect. Any of these forms of discrimination are sufficient to trigger heightened scrutiny. Under the Fifth Circuit's "business form" test, however, facially neutral statutes are effectively immune from challenge. Because the "Commerce Clause forbids discrimination, whether forthright or ingenious," it is the court's "duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce." *West Lynn Creamery*, 512 U.S. at 201-02.

The Fifth Circuit's "business form" shortcut does not comport with the "sensitive, case-by-case analysis of purpose and effects" mandated by this Court. *Id.* Because the Commerce Clause is "not so rigid as to be controlled by the form by which a State erects barriers to commerce," *id.*, it is not permissible to cease the analysis upon a finding of facial neutrality. Rather, after concluding that the legislature discriminated "not on the basis of domicile but on the basis of business form," the Fifth Circuit should have determined whether the purpose (or effect) of drawing this distinction was to favor a predominantly local class of competitors over a largely out-of-state class of competitors.

The Court of Appeals' failure to examine the purpose or effect of the state legislation conflicts both with this Court's prior precedents and the decisions of other circuits. *Best & Co. v. Maxwell*, 311 U.S. 454 (1940), is directly on point. During the Depression, North Carolina drew a "business form" distinction between "regular retail merchants" and those who sold their wares out of rented hotel rooms. Although "[n]ominally the statute taxes all who are

not regular retail merchants in North Carolina, regardless of whether they are residents or nonresidents," the *Best* Court found the statute discriminatory because the tax tended to apply primarily to out-of-state retailers, while exempting most in-state retailers. *Id.* at 456.

Likewise, in *Hunt v. Washington State Apple Advertising Comm.*, 432 U.S. 333 (1977), this Court condemned facially neutral, "business form" discrimination as purposefully discriminatory. In striking down the requirement that all apples be labeled in accordance with the USDA grading system (to the disadvantage of growers from states with more stringent systems), the Court held that a State may not neutralize the advantages of an out-of-state competitor by "stripping away ... the competitive and economic advantages it has earned." *Id.* at 351.

So too, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), this Court invalidated a facially-neutral state statute that gave tax preferences to a predominantly local "business form" – particular types of Hawaiian alcoholic beverages – at the expense of the predominantly out-of-state producers and distributors of other types of alcohol. Because the state legislature passed the statute to promote demand for the favored local liquor at the expense of other (predominantly, but not exclusively out-of-state) forms of alcoholic beverages, the Court invalidated the law as purposefully discriminatory.

Here, the Fifth Circuit made no attempt to reconcile its "business form" approach with *Best*, *Hunt*, or *Bacchus*. Those decisions recognize that,

when a State targets a business model for local protectionist purposes (or reaps the benefits of such targeting by achieving a discriminatory shift of business in its residents' favor), the statute should be condemned just as if it facially barred out-of-state competition.

2. The Fifth Circuit's "business form" test also conflicts with this Court's "mixed motive" cases. Under this Court's precedents, once a statute is found to discriminate in purpose (*e.g.*, *Hunt*) or effect (*e.g.*, *West Lynn Creamery*), any legitimate purpose offered for the state regulation must be subjected to heightened scrutiny. The Fifth Circuit did not do this. On the contrary, the court below essentially applied the "rational basis" test to "business form" discrimination.

While the Fifth Circuit acknowledged that the legislative record reflected "both consumer protection and local industry concerns," it nonetheless held that the legislators' "protectionist remarks" were "insufficient to condemn the statute." App. 17a. It initially framed its inquiry as a search for the law's "primary" motivation. It ultimately concluded, however, that it was too "difficult to say from the legislative history what primary factor motivated passage of the legislation," since "both sides find passages from the legislative history supporting their view." App. 6a.

Having failed in its quest to identify a "primary" motivation, the Fifth Circuit, citing *Maine v. Taylor*, 477 U.S. 131 (1986), held that a "protectionist motivation for challenged legislation" would not violate the Commerce Clause unless "the state had

no legitimate interest in enacting the challenged regulation." App. 17a-18a n.29 (emphasis added).

This deferential, "no legitimate interest" approach badly misreads *Maine v. Taylor*. The *Taylor* Court subjected the challenged law to rigorous strict scrutiny. Based upon the elaborate record at trial, the Court concluded that the Maine statute was justified under that higher standard by unique environmental considerations. In the passage the Fifth Circuit cited, the Court simply noted that a few protectionist remarks did not render the State's purported justification "pretextual" (which would have obviated the need to evaluate the strength of the justification). 477 U.S. at 150-51. The Court never held, as the Fifth Circuit has now done, that the mere presence of an arguably legitimate purpose somehow forecloses heightened scrutiny.[2]

The Fifth Circuit's deferential approach is also inconsistent with this Court's rulings in *Hunt* and *West Lynn Creamery*, both of which were mixed-motive cases. As the *Hunt* Court observed, a finding

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2 The Fifth Circuit's failure to identify a "primary" protectionist purpose reflects a failure to consider all of the relevant evidence, as required, from an "objective observer's" viewpoint. *McCreary County v. Am. Civil Liberties Union of Ky.*, 545 U.S. 844, 862 (2005).

Specifically, as discussed *infra* in Section II at 22-25, the Fifth Circuit limited its review solely to the "official" legislative history. It did not consider the timing of the law, the specific events leading to its passage, the source of the legislation, or the other statements made by the legislators and lobbyists in drafting the legislation. But even if the Fifth Circuit was justified in discerning two "roughly equal" motivations, it failed to follow this Court's directive to evaluate the supposedly legitimate purpose through the lens of heightened scrutiny.

of a "legitimate local concern" does not "end the inquiry," since it "'would mean that the Commerce Clause ... imposes no limitations on state action ... save for the rare instance where a state artlessly discloses an avowed purpose to discriminate.'" 432 U.S. at 350 (quoting *Dean Milk Co. v. Madison*, 340 U.S. 349, 354 (1951)).

There, the Court applied strict scrutiny despite the State of North Carolina's invocation of consumer-protection rationales (not unlike the rationales invoked by Texas to support HB 1131), declaring that the challenged statute's discriminatory effect was not "an unintended by-product" of the legislation. *Hunt*, 432 U.S. at 352. Similarly, in *West Lynn Creamery*, the Court held that, "even if environmental preservation were the *central* purpose of the pricing order, that would not be sufficient to uphold a discriminatory regulation." 512 U.S. at 205 n. 20 (emphasis added).

Other circuits have applied *Hunt's* and *West Lynn Creamery's* teachings, not the Fifth Circuit's "primary" purpose test. *See, e.g., Waste Mgmt. Holdings, Inc. v. Gilmore*, 252 F.3d 316, 336, 340-41 (4th Cir. 2001) (noting that, in mixed-motive cases, strict scrutiny is triggered by a discriminatory purpose, and the issue of whether the State has a "valid reason for engaging in ... discrimination is the focus of the strict scrutiny inquiry"); *McNeilus Truck & Mfg., Inc. v. Ohio*, 226 F.3d 429, 443-44 (6th Cir. 2000) (same).

3. The Fifth Circuit's "business form" test also conflicts with this Court's, and other Circuits', discriminatory effects jurisprudence. In *Exxon*, this

Court established that, in analyzing a statute's effects, the focus should be on the "relative proportions of local and out-of-state" goods and services impacted by the statute. *Exxon Corp. v. Governor of Md.*, 437 U.S. 117, 126 n.16 (1978). Two years later, in *Lewis*, 447 U.S. at 37, this Court reiterated that the "validity of state laws must be judged chiefly in terms of their probable effects." Yet neither the district court nor the Fifth Circuit examined HB 1131's relative or probable effects. Instead, the court below – extending prior Fifth Circuit precedent – established a *per se* rule for "business-form" discrimination. In the lower court's view, the effects imposed by statutes that discriminate against a "business form" are irrelevant.

This ruling cannot be squared with this Court's Commerce Clause jurisprudence. Both this Court and lower courts subsequent to *Exxon* have tested whether the "probable effects" of a statute are discriminatory by employing what has been referred to in this litigation as the *Exxon* "business shifting test." Under that test, a state statute has a discriminatory effect *if* it causes "local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market." *Exxon*, 437 U.S. at 126 n. 16; *see also West Lynn Creamery*, 512 U.S. at 195-96 (quoting and applying *Exxon's* test). Heightened scrutiny therefore applies when a state statute: (i) disproportionately burdens out-of-state firms, (ii) disproportionately benefits competing in-state firms, and (iii) thereby shifts business from the former to the latter.

HB 1131 indisputably exerts this business shifting effect. The burdened class – vertically-integrated, insurer-owned collision repair facilities – consists exclusively of out-of-state firms. App. 8a. Indeed, HB 1131 directly the Allstate-Sterling initiative, the immediate and most significant competitive threat to Texas' "mom-and- pop" body shops. The benefited class – independent body shops – are overwhelmingly local. As the district court acknowledged, there are only a "relatively few (about five)" interstate firms. App. 56a.

By blocking Sterling's planned expansion in Texas (and thereby halting further implementation of Allstate's plan for a nationwide network), HB 1131 protects local body shops from competition with their most significant out-of-state rival. As such, the statute impermissibly "perpetuate[s] local dominance," an effect other circuits rightly condemn. *See, e.g., Walgreen Co. v. Rullan*, 405 F.3d 50, 59 (1st Cir. 2005) (invalidating statute where "the statistics ... strongly suggest that the Act helps to perpetuate local dominance."). Such condemnation is appropriate to prevent the balkanization of the nation's economy, as "the practical effect of [a law] must be evaluated not only considering the consequences of the statute itself, but also by considering ... what effect would arise if not one, but many or every, [jurisdiction] adopted similar legislation." *Carbone*, 511 U.S. at 406 (O'Connor, J., concurring) (alteration in original).

In contrast to other courts, the Fifth Circuit declined to apply *Exxon's* business-shifting test. The lower court's stated rationale was that a threshold question for application of the test is whether the

burdened and benefited classes are "similarly situated." Relying on its "business form" distinction, the Fifth Circuit held that the "independent" local body shops and the Allstate/Sterling "insurer-owned" body shops were different "business forms" and thus were not "similarly situated in-state and out-of-state interests." App. 18a, 21a.

This form-over-substance approach does not comport with this Court's teachings. *See, e.g., West Lynn Creamery, supra.* Of course, "'[a]ny notion of discrimination assumes a comparison of substantially similar entities.'" *United Haulers, 127 S.Ct. at 1789* (quoting *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 298 (1997)). But, the relevant question here is: what does it mean to be "similarly situated"?

That question was answered conclusively in *Tracy* and *Bacchus*: if the favored and disfavored firms "compete," then they are "similarly situated." *Bacchus*, 468 U.S. at 271; *Tracy*, 519 U.S. at 278. As the *Bacchus* Court observed, discrimination occurs "as long as there is some competition between the locally produced ... products and [the] products from outside the State." *Bacchus*, 468 U.S. at 271. Indeed, the Court applied strict scrutiny despite (i) product and distribution differences; and (ii) the fact that the local producers had just one percent of the Hawaiian liquor market. *Id.*

In *Tracy*, the Court noted that, in analyzing the "threshold question whether the [favored and disfavored] companies are indeed similarly situated for constitutional purposes," the focus is on whether "the different entities serve different markets, and

would continue to do so even [absent] the supposedly discriminatory burden." *Tracy*, 519 U.S. at 299. There, this Court upheld the statute, but only because, "in the absence of actual or prospective competition between the supposedly favored and disfavored entities in a single market, there can be no local preference." *Id.* at 300.

Just last term, this Court reiterated its view that interference with competition in the private market between disfavored foreign firms and favored domestic ones triggers "rigorous scrutiny." Although it ultimately upheld the challenged regulation, this Court did so because when a State "nationalizes" a market – pre-empting all private competition, whether local or foreign – the Commerce Clause is not implicated because the State has not favored in-state private competitors over interstate ones. *United Haulers*, 127 S.Ct. 1786.

Here, the State is not seeking to displace private competition; rather, it seeks to protect a predominantly local industry from an inherently interstate rival. This is impermissible, as other lower courts recognize. *See Nat'l Revenue Corp. v. Violet*, 807 F.2d 285 (1st Cir. 1986) (applying competition test to find that lawyers and debt collectors are similarly situated with respect to debt collection activities); *Nat'l Assn. of Optometrists*, 463 F. Supp. 2d at 1129 (applying competition test to find that opticians and optometrists were similarly situated; observing that "in conducting the 'similarly situated' inquiry, courts have consistently considered whether entities engage in competition rather than whether the entities are of different types.").

The Fifth Circuit never discussed the *Tracy/Bacchus/United Haulers* competition test. This was based – again – on misplaced reliance on *Exxon*, which the lower court had cited for its "business form" exemption for local economic protectionist legislation. But *Exxon* nowhere articulated such a broad rule. *Cf. United Haulers*, 127 S.Ct. at 1794 ("[a]n opinion which is to ... establish a principle never before recognized, should be expressed in plain explicit terms.").

Instead of applying the business-shifting analysis required by *Exxon*, the Fifth Circuit focused on *Exxon's* upholding of the anti-oil industry, vertical integration statute at issue there. But the *Exxon* Court did not announce a *per se* rule of legality for vertical integration prohibitions, let alone for "business form" discrimination. To the contrary, *Exxon* made clear that the constitutionality of such statutes depends on a searching analysis of whether the state action impacts "the relative proportions of local and out-of-state goods [or services] sold" in the State. 437 U.S. at 126 n.16.

While the *Exxon* Court upheld the Maryland statute under review, it did so because the *Exxon* business shifting test was not satisfied. The law did not impede sales across state lines; out-of-state oil refineries could still sell their gasoline into the local markets, indirectly through distributors. Exxon thus still had "access" to the local gasoline market. Nor did the law favor in-state refiners; there were none.

Relatedly, because "goods" (in the form of gasoline) were the subject of concern, the *Exxon*

Court did not have to deal with the ancillary retail *services* market (the type of market at issue here). Even if the Court had so focused, Maryland's statute did not demonstrably shift retail services from out-of-state to locally-domiciled service providers. As the *Exxon* Court noted, there were other interstate firms that could "promptly replace" any retail business that the integrated manufacturers lost. *Id.* at 127.

Here, in sharp contrast, HB 1131 restricts Allstate/Sterling's access to the Texas collision repair market. Because of the barriers to entry protecting local body shops (which insurer-ownership overcomes), other interstate firms cannot "promptly replace" the Greenfield facilities Sterling had planned to build. As such, HB 1131 protects local body shops from their most significant out-of-state competitor, causing "local [services] to constitute a larger share, and [services] with an out-of-state source to constitute a smaller share, of the total sales in the market." *Exxon*, 437 U.S. at 126 n.16.

II. This Court Should Grant Certiorari To Resolve the Lower Court Conflicts Concerning the Constitutionality of Local Economic Protectionist Legislation.

The Fifth Circuit's decision not only conflicts with this Court's decisions, it also conflicts with those of other circuits. These conflicts stem from a fundamental disagreement among the lower courts concerning how much judicial deference to afford to economic protectionist legislation taking the form of "business model" or "Anti-Wal-Mart-like" legislation.

On one side stands the Fifth Circuit. That court deferentially curtails its inquiry into legislative purpose (essentially taking the statute at face value) and grants broad leeway to create facially-neutral statutory classifications, regardless of purpose or effect, so long as some arguably legitimate basis can be articulated. On the other side stands the First, Fourth, Seventh, and Eighth Circuits. Those circuits analyze – from an "objective observer" viewpoint – whether the purpose or effect of a statute is to protect a predominantly local industry from competition from out-of-state competitors.

This Court should grant certiorari both to resolve this conflict and to clarify the extent of state power to enact legislation that targets the competitive advantages of more efficient, innovative out-of-state firms. Specifically, three circuit conflicts loom, all crying out for urgent resolution.

1. Lower courts have split over how to discern legislative intent for Dormant Commerce Clause purposes. Here, the Fifth Circuit curtailed its review of the legislative history, willfully blinding itself to probative, credible evidence of protectionism. By limiting its review to transcripts of legislative hearings – where both protectionist and consumer harm rationales were articulated (the latter, with one exception, by body shops and their lobbyists, not consumers) – the Fifth Circuit loosely opined that the two rationales were roughly equal. App. 69. That cabined approach is inappropriate. Had the Court of Appeals considered the timing and the source of the legislative proposal, or the realities of its specific targeting of the competitive threat posed by Allstate's and Sterling's interstate network, then

the Fifth Circuit would have been compelled to recognize that protecting the local Texas body shop owners *was* the "primary" purpose.

That evidence, briefly summarized in the Statement of the Case, *supra,* indisputably demonstrated that HB 1131 was "drafted at the request" of a local body shop owner to protect local profits. Indeed, the record reveals that the Allstate/Sterling-centric text of HB 1131 was written by the body shop lobbyists. App. 79a. That evidence was brushed aside by the Fifth Circuit, despite the fact that the district court found that the statute was "spurred by a coalition of small business owners who compete with ... Sterling." *Id.* Nor did the Fifth Circuit consider the source (body shop lobbyists) of the "evidence" of the so-called "conflict of interest" arising from insurer ownership. The Court also failed to consider – despite extensive pre-trial document and deposition discovery of Allstate and Sterling – the lack of any, let alone credible, probative evidence of a pattern, practice, or policy of "cutting corners" on collision repairs by Allstate or Sterling.

This Court has historically analyzed all evidence to determine a statute's actual intent, both for Commerce Clause and other analytic purposes. *See, e.g., Hunt,* 432 U.S. at 352 (discerning discriminatory purpose from the state regulator's statement that he would "want to have the sentiment from our apple producers since they were mainly responsible for this legislation being passed") (internal quotations and citations omitted); *Kassel v. Consol. Freightways Corp.,* 450 U.S. 662, 685 (1981) (Brennan, J., concurring) (relying on Governor's

parochial statements in concluding that the "purpose, being protectionist in nature, is impermissible under the Commerce Clause").

In failing to consider all the powerful evidence, the Fifth Circuit failed to apply the "objective observer" standard of statutory review set forth in *McCreary County v. Am. Civil Liberties Union of Ky.*, 545 U.S. 844, 862 (2005). There, this Court declared that to discern legislative intent, courts must assume the posture of an "objective observer," who "takes account of the traditional external signs that show up in the text, legislative history, and implementation of the statute" and looks to the "historical context of the statute ... and the specific sequence of events leading to [its] passage." *Id.* (internal citations omitted).

Faithful to this Court's directive, other circuits have examined holistically the totality of the relevant evidence in order to identify the challenged statute's legislative purposes. In *McNeilus*, the Sixth Circuit struck down a licensing statute that required all vehicle re-manufacturers to enter into servicing agreements with local Ohio truck dealers. Relying on "several letters by in-state dealers and re-manufacturers to the Ohio Legislature seeking this legislation," the court found a discriminatory purpose, concluding that the "state gives away the game when it concedes to discriminating against McNeilus's business model." *McNeilus*, 226 F.3d at 443-44.

In like manner, the Eighth Circuit, in a series of cases, condemned "business form" statutes that prohibited corporations from owning farm land. In

those cases, the Eighth Circuit, after evaluating the legislative record, held that the facially-neutral prohibition of the corporate business form for agricultural enterprises was motivated by a desire to protect predominantly local farmers from out-of-state competition. *See Jones v. Gale*, 470 F.3d 1261 (8th Cir. 2006); *South Dakota Farm Bureau, Inc. v. Hazeltine*, 340 F.3d 583, 594, 596 (8th Cir. 2003); *see also SDDS, Inc. v. South Dakota*, 47 F.3d 263, 272 (8th Cir. 1995) (finding discriminatory purpose based on "protectionist propaganda," and a dubious connection between purported interests and statutory provisions).

2. Lower courts have struggled to harmonize *Exxon* with this Court's other Commerce Clause decisions. Citing *Exxon*, the Fifth Circuit concluded that the "business model" discrimination it confronted was not a quality that condemned HB 1131, but a loophole that saved it. But as another court observed, "*Exxon* has not overruled any part of *Hunt* and when a statute gives in-state companies an advantage over out-of-state companies," it is discriminatory. *Pete's Brewing Co. v. Whitehead*, 19 F. Supp. 2d 1004, 1014 (W.D. Mo. 1998). Other lower court judges have noted that *Exxon* is "woefully out of step with the [Supreme] Court's more recent cases," and that the seemingly protectionist ban on vertical integration that it upheld is "about as negative toward interstate commerce as legislative action can get." *Ford Motor Co. v. Texas Dep't. of Transp.*, 264 F.3d 493, 512 (5th Cir. 2001) (Jones, C.J., concurring).

Attempting to harmonize *Exxon* with this Court's Commerce Clause jurisprudence, lower

courts have fashioned two irreconcilable approaches: Some, including the Fifth Circuit, have held that *Exxon* creates a *per se* rule of validity for facially-neutral, anti-vertical integration statutes. The upshot is an unquestioning judicial acceptance of state statutes whose proven purpose and effect is to shift business to local firms. *See Ford Motor Co.*, 264 F.3d at 493; *Int'l Truck & Engine Corp. v. Bray*, 372 F.3d 717 (5th Cir. 2004), *opinion corrected on other grounds*, 380 F.3d 231 (2004); *see also LensCrafters, Inc.*, 403 F.3d at 798 (upholding prohibition on eyeglass sellers from providing optometry services).

Other courts more benignly view *Exxon* as a straightforward application of the "business shifting" test that *Exxon* itself articulated. This Court, for example, has subsequently applied *Exxon*'s business-shifting analysis to invalidate a facially neutral statute. *See West Lynn Creamery*, 512 U.S. at 196 (invalidating state law that "will almost certainly 'cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market.'") (quoting *Exxon*, 437 U.S. at 126 n.16). Other courts have done the same. *See, e.g., Walgreen*, 405 F.3d at 59 (distinguishing *Exxon* and applying strict scrutiny where the "the statistics [here] ... strongly suggest that the Act helps to perpetuate local dominance."); *Gov't Suppliers Consol. Servs., Inc. v. Bayh*, 975 F.2d 1267, 1279 (7th Cir. 1992) (distinguishing *Exxon* because the Maryland statute had "no demonstrable effect whatsoever on the interstate flow of goods.").

Clarification as to *Exxon*'s proper bounds and its applicability to "business form" discrimination is

urgently needed. Specifically, the Court should make clear that *Exxon* does not create a rule of essentially *per se* validity for "business form" discrimination, but rather requires courts to examine carefully the relevant evidence under *Exxon's* own business-shifting standard.

3. Lower courts have also divided over what it means for in-state and out-of-state firms to be "similarly situated." The Fifth and Sixth Circuits hold that firms are "similarly situated" only if they are identical or the legislation targets the disfavored firm's domicile. *See Ford Motor Co.*, 264 F.3d 493; *LensCrafters, Inc.* 403 F.3d 798. In contrast, the First Circuit, Eighth Circuit, and courts within the Ninth Circuit apply the *Bacchus/Tracy/United Haulers* "competition" test to determine if firms are similarly situated for Commerce Clause purposes. *See Nat'l Revenue Corp.*, 807 F.2d at 285 (lawyers and debt collectors are similarly situated with respect to debt collection activities); *Nat'l Assn. of Optometrists*, 463 F. Supp. 2d at 1116 (law barring non-licensed optometrists from selling eyewear violates Dormant Commerce Clause).

LensCrafters and *Nat'l Assn. of Optometrists* best exemplify the analytical confusion. In these two cases, courts reached opposite conclusions, notwithstanding that they involved almost precisely the same parties and facts.

Certiorari is needed to eliminate these economically important and constitutionally significant conflicts.

CONCLUSION

For the foregoing reasons, this Court should grant the petition and reverse the decision of the Court of Appeals.

Respectfully submitted,

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December 10, 2007

APPENDIX

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United States Court of
Appeals Fifth Circuit
FILED
August 1, 2007
Charles R. Fulbruge III
Clerk

No. 06-10500

ALLSTATE INSURANCE COMPANY and
STERLING COLLISION CENTERS, INC.

Plaintiffs-Appellants/Cross-Appellees,

v.

GREG ABBOTT, in his official capacity as Attorney General of Texas, and SUSAN COMBS, in her official capacity as Texas Comptroller of Public Accounts,

Defendants-Appellees/Cross-Appellants

v.

AUTOMOTIVE SERVICE ASSOCIATION and
CONSUMER CHOICE FOR AUTOBODY REPAIR,

Intervenors-Appellees/Cross-Appellants

Appeal from the United States District Court for the Northern District of Texas.

Before KING, DAVIS and BARKSDALE, Circuit Judges.

W. EUGENE DAVIS, Circuit Judge:

Allstate Insurance Co. ("Allstate") and Sterling Collision Centers, Inc. ("Sterling") brought this action against Greg Abbott and Susan Combs as Defendants in their official capacities as Attorney General of Texas and Texas Comptroller of Public Accounts (collectively "State Defendants")[1] to

challenge a Texas statute known as House Bill 1131 (codified as Tex. Occ. Code § 2307.001, et seq.). H.B. 1131 restricts the right of an auto insurer to own and operate auto body shops in Texas. Allstate and Sterling argue the statute violates the dormant Commerce Clause and the First Amendment of the United States Constitution.

After a bench trial, the district court rejected Allstate's dormant Commerce Clause challenge but found that certain provisions of the statute violated the First Amendment. We AFFIRM.

I. FACTUAL AND PROCEDURAL BACKGROUND

In 2000, Allstate, a Delaware insurance company holding approximately 15% of the automobile insurance market in Texas, implemented a plan to enter the auto body repair business by acquiring Sterling, a multi-state chain of repair shops. Sterling operates approximately 60 auto body repair shops in 14 states, including 15 shops in the state of Texas. Allstate planned to improve existing Sterling facilities and to cultivate new ones. By influencing its customers and other claimants to obtain repair work from Sterling rather than from unaffiliated shops, Allstate believed it could minimize charges for unnecessary or overpriced repairs.

At the time of its acquisition of Sterling, Allstate maintained a relationship with several local body shops in Texas through a program called the Priority Repair Option ("PRO"). Allstate recommended the PRO shops to its insureds and other claimants if the shops maintained a certain level of quality and efficiency. If a customer chose to go to a PRO shop, Allstate provided a guarantee for the repairs performed and became the direct purchaser for the

repair services. Allstate found that most PRO shops had a lower average repair cost than other body shops. However, while the PRO program led to some cost savings, Allstate-still troubled by the prevalence of fraud and inefficiencies in repair work (even in PRO shops) and seeking to gain an advantage over competitors that maintained similar programs-decided to explore auto body shop ownership as an additional strategy for cost savings.

After its acquisition of Sterling, Allstate had its telephone service representatives use a script in speaking with policyholders and other claimants. Representatives would first offer the services of the Sterling shops to policyholders, without offering a referral to PRO shops as had been done previously. Allstate followed this approach to boost business at Sterling shops which had lost their pre-existing referral relationships with other insurers after Allstate's acquisition. Under the new practice, Allstate referred policyholders to PRO shops only when asked.[1]

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[1] The script read as follows:

Mr./Mrs. _____, of course you are always free to choose any repair shop and are under no obligation or requirement to use a shop we recommend, however, I would like to make you aware of the benefits of Sterling Auto Body Centers, which are affiliated with the Allstate Corporation.

Sterling Auto Body Centers are highly respected and provide exceptional customer service. Sterling provides a lifetime guarantee as long as you own your vehicle on both parts and labor. In addition, they will handle all the paper work, keep you

In addition to using this sales pitch from the script, Allstate sought to boost Sterling's market share by eliminating its PRO relationship with shops that were near a Sterling shop, thus funneling repair opportunities to Sterling.

In 2003, the Texas Legislature began considering H.B. 1131, a bill which would bar insurers from acquiring an interest in auto body shops. The parties dispute the precise motivation for the bill's introduction and passage. Allstate claims that the bill was part of a coordinated political strategy to hurt its venture with Sterling and to maintain the dominance of local Texas body shops. The State Defendants argue that the bill grew out of concerns for customer welfare, particularly that Allstate's dual role as insurer and body shop owner would create a conflict of interest and an incentive to short change customers.

Transcripts of the legislative hearings on the bill reflect both consumer protection and local industry concerns. On consumer protection, members in the House and Senate heard testimony from several individuals, many of them affiliated with body shop trade groups, detailing the danger of insurance company ownership of auto body repair shops. These witnesses all warned of the conflict of interest inherent in such an arrangement, arguing that it

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updated throughout the repair process, guarantee a completion date, and, even, professionally clean your vehicle inside and out. They can also assist with rental arrangements on site and will pay for additional rental expenses if the guaranteed delivery date is missed.

raised the risk of illegal customer steering. The witnesses also predicted that such arrangements would encourage body shops "tied" to insurers to cut corners in an effort to reduce repair costs.[2] Legislators also heard about the adverse impact on local industry which would result from Allstate's entry into the auto body repair business. For instance, the Vice President of the Automotive Services Association warned that the rise of insurer owned repair shops would lead to the demise of the independent repair industry, along with billions of dollars in local economic impact and hundreds of thousands of jobs. Another bill proponent, a body shop owner, told the House Committee about how his shop had been forced from Allstate's PRO referral program after a Sterling shop opened down the street. Several representatives for Allstate also spoke at the hearings. These individuals attempted to assuage fears about illegal steering and to frame the bill as an obstacle to consumer choice.

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[2] Both customers and body shop owners testified in support of these concerns. One customer who had been involved in an accident with an Allstate insured told the committee that Allstate discouraged him from taking his car to an independent shop by asserting that the shop kept cars longer than necessary, a claim the witness said was untrue. He further stated that Allstate did not give the shop adequate time to complete repairs. Another witness, a body shop owner, testified that Allstate's management had refused to agree with its own on-site adjuster's assessment that a car was a total loss and instead insisted that the car be repaired.

It is difficult to say from the legislative history what primary factor motivated passage of the legislation. We have the not unusual situation where both sides find passages from the legislative history supporting their view of the predominant reason for the legislation.[3]

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[3] For instance, Representative Flores's explanation of the bill prominently highlighted local industry concerns:

> REP. FLORES: What this seeks is to remedy a situation that is occurring in a lot of the major metropolitan areas, which is- and it's spreading, and it's allowing insurance companies, which are purchasing and building body shops, *to compete with those run by our local independent folks back home* in our communities.

Hearing on Tex. H.B. 1131 Before the House Comm. on Licensing & Admin. Procedures, 78th Leg., R.S. [hereinafter "H.B. 1131 House Hearing"] 2 (March 6, 2003) (emphasis added). Similarly, Representative Homer at the same hearing and then Senator Carona in a subsequent Senate hearing commented on the issue of competition with local industry:

> REP. HOMER: Because I'm a small businessman ..., there's nothing that angers me more than when the big guy comes in and just ... run[s] you out of town.... It's kind of the Wal-Mart scenario.

H.B. 1131 House Hearing, pg. 92.

> SEN. CARONA: I think the most significant thing we've tried to do here is ... just make

H.B. 1131 was passed on May 27, 2003, and took effect on September 1, 2003. As enacted, it accomplished two broad reforms. First, the new law generally prohibits an insurer from owning or acquiring an interest in an auto repair facility.[4] However, facilities already open for business at the

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> sure that-in the shops that the insurance companies actually own ... we don't let those actual shops owned by the insurance companies have any kind of competitive advantage in a region.

Hearing on Tex. H.B. 1131 Before the Senate Comm. on Bus. & Commerce, 78th Leg., R.S., 11 (May 20, 2003).

> On the other hand, several comments and questions by various members focused on consumer protection:
>
> > REP. WISE: [D]id you say that some employees at Sterling have anonymously told you that their customers are being steered to them by their adjustors?
> >
> > REP. DELWIN: [To Allstate lobbyist] I'd like to hear how would you address some of the allegations that you've heard about Allstate adjustors basically forcing people into Sterling....
> >
> > REP. DRIVER: But the concept and what the concern is here is how many of those Sterling clients are Allstate clients? How many of them are being directed that way?
>
> H.B. 1131 House Hearing, pg.14, 41, 73.

[4] Tex. Occ. ode § 2307.002.

time of the bill's passage are exempted.[5] Second, the statute establishes a set of rules to govern these existing shops. Most notably, it requires an insurer to offer the same referral arrangement it has with its tied body shop to at least one unaffiliated body shop.[6] The law does not require that an insurer treat *all* body shops the same, only that the insurer extend an invitation into a referral program to at least one untied shop and that the insurer treat all tied and untied shops in that referral program the same.

H.B. 1131 carries no criminal penalties. It instead creates a private cause of action in "any person aggrieved by a violation of the statute."[7] Based on the seriousness of the violation, a court may impose a civil penalty which is to be sent to the comptroller for deposit in the state's general revenue fund.[8]

Allstate and Sterling are the only entities affected by the law because Sterling is the only body shop in Texas directly owned by an insurer and Allstate is the only insurer in Texas which owns a body shop.

In 2003, Allstate filed the present suit, claiming that H.B. 1131 violates the dormant Commerce Clause and the First Amendment. Allstate argued

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[5] *Id.*

[6] Tex. Occ. Code § 2307.006(11) ("An insurer may not enter into a favored facility agreement exclusively with its tied repair facilities.").

[7] Tex. Occ. Code § 2307.009(a).

[8] Tex. Occ. Code § 2307.009(b).

that because H.B. 1131 forecloses Sterling, an interstate body shop, from opening more body shops in Texas, the purpose and effect of the law is to discriminate against interstate commerce. The company acknowledged that while the law does not accomplish this discrimination directly by using statutory classifications based on domicile, the law was adopted for the purpose, and has the effect, of advantaging local industry at the expense of Sterling, a non-resident. Allstate also claimed that the bill's provisions, which make Allstate's ability to promote Sterling shops contingent on Allstate's promotion of other body shops, run afoul of the First Amendment's protection of truthful and non-deceptive commercial speech.

A bench trial was completed in October 2004. At the conclusion of the trial, the district court upheld the bill's restrictions on the acquisition of auto body repair shops. The district court found that the bill was not intended to, nor did it have the effect of, discriminating against interstate commerce. Rather, the district court explained, H.B. 1131 created different treatment of two business forms, independent (or "mom and pop") operations on the one hand versus auto body repair shops owned by insurance companies on the other hand-a permissive basis for discrimination. However, the district court concluded that the bill's speech provisions violated the First Amendment. The court explained that H.B. 1131's provisions were not sufficiently narrow and instead served to deprive consumers of information which may be beneficial. The judge observed that the need for the speech provisions was questionable since Texas consumers already enjoyed the benefit of an anti-steering law, which prohibits insurers from requiring policyholders to use a

certain auto body shop.[9] The court reasoned that less restrictive means existed to accomplish the consumer welfare aims, for instance, a simple requirement that Allstate disclose its ownership of Sterling.

Allstate appeals the dormant Commerce Clause ruling. The State Defendants defend that portion of the judgment but find fault with the First Amendment aspect of the trial court's ruling.

II. JURISDICTION

This case was brought initially in Dallas county state court pursuant to the Texas Declaratory Judgment Act.[10] On September 23, 2006, the State

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[9] *See* Tex. Ins. Code § 5.07-1(b)(2).

[10] Tex. Civ. Prac. & Rem. Code § 37.004(a) ("a person ... whose rights ... are affected by a statute ... may have determined the question of construction or validity arising under the ... statute ... and obtain a declaration of rights ... thereunder."). Under the TDJA, the Attorney General is a necessary party where the validity of a statute is at issue. *See* Tex. Civ. Prac. & Rem. Code § 37.006(b). Texas courts have recognized that the TDJA waives the state's sovereign immunity. *See Tex. Educ. Agency v.* Leeper, 893 S.W.2d 432, 446 (Tex.1994) ("[B]y authorizing declaratory judgment actions to construe the legislative enactments of governmental entities and authorizing awards of attorneys fees, the [Declaratory Judgments Act] necessarily waives governmental immunity for such awards."); *see also Wichita Falls State Hosp. v. Taylor,* 106 S.W.3d 692, 698 (Tex.2003) (stating that if the Legislature required the State to be joined in a lawsuit for which

Defendants timely removed the case to federal district court. The parties agree that this removal accomplished a waiver of the state's Eleventh Amendment immunity.[11]

The State Defendants argue that the dispute does not satisfy Article III's case or controversy requirement. In order to establish a case or controversy sufficient to give a federal court jurisdiction over their claims, plaintiffs must satisfy three criteria: (1) they must show that they have suffered, or are about to suffer, an "injury in fact"; (2) "there must be a causal connection between the injury and the conduct complained of"; and (3) "it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision."[12]

While conceding that Allstate has suffered an injury, the State Defendants cite our decision in *Okpalobi v. Foster*[13] in support of their argument that causation and redressability are lacking in this case. In *Okpalobi*, we considered whether a district court had properly enjoined the operation and effect

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immunity would otherwise attach, the Legislature intentionally waived the State's sovereign immunity and noting that *Leeper* stands for the proposition that the TDJA does waive aspects of sovereign immunity).

[11] *See Lapides v. Bd. of Regents of Univ. Sys. Of Ga.*, 535 U.S. 613, 620 (2002).

[12] *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560, (1992) (citation omitted).

[13] 244 F.3d 405, 426-27 (5th Cir.2001) (en banc).

of a Louisiana state tort statute which made abortion providers liable to patients in tort for any damage occasioned by abortions. We concluded that because the named defendants (the Governor and the Attorney General) had caused no injury to the plaintiffs and could never themselves cause any injury under the private civil scheme, the plaintiffs failed to fulfill Article III's case and controversy requirement.[14]

Okpalobi does not control this case. A case brought against a state officer in his official capacity is essentially a suit against the state.[15] While the states are immune from suit under the Eleventh Amendment, *Ex parte Young* allows a plaintiff to avoid this bar by naming a state official for the purpose of enjoining the enforcement of an unconstitutional state statute. In turn, *Young* requires that "[i]n making an officer of the state a party defendant in a suit to enjoin the enforcement of an act alleged to be unconstitutional, ... such officer must have some connection with the

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[14] *Id.* at 426.

[15] *See, e.g., Diamond v. Charles*, 476 U.S. 54, 57 n. 2 (1986) (stating that "[a] suit against a state officer in his official capacity is, of course, a suit against the State"); *Kentucky v. Graham*, 473 U.S. 159, 166 (1985) (noting that suits against state agents are just another way of pleading actions against the state); *McCartney v. May*, 50 S.W.3d 599, 606 (Tex. App.-Amarillo, 2001, no pet.)("[a] claim against a state employee in [his] official capacity is, in effect, a claim against the state," and thus, "to that extent, the state is a party.").

enforcement of the act, *or else it is merely making ... the state a party.*"[16] Because neither the authority of the Louisiana Governor nor Attorney General extended to enforcing the provision challenged by the *Okpalobi* plaintiffs, the Eleventh Amendment remained a bar to the suit. Our standing analysis was thus limited to an examination of whether causation and redressability could be linked to the enforcement connection the Governor and Attorney General had with the statute.[17]

Unlike *Okpalobi*, the state removed this case to federal court and thereby waived its Eleventh Amendment immunity. Therefore, because it is unnecessary to employ the fiction of *Young* to defeat the state's immunity, the connection between the state officer named in the suit and the enforcement of H.B. 1131 is irrelevant to our standing analysis. Rather, the state is the real party in interest.

Because the state itself is a party, causation and redressability are easily satisfied in this case. Causation is satisfied because the state passed H.B. 1131, a law which threatens Allstate with private civil law suits and civil penalties if it continues with its business plan to acquire additional Sterling body shops. A declaration of unconstitutionality directed against the state would redress Allstate's injury because it would allow Allstate to avoid these

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[16] *Ex parte Young*, 209 U.S. 123, 157 (1908) (emphasis added).

[17] *See Okpalobi*, at 426-27.

penalties and lawsuits.[18] Accordingly, we are satisfied that a genuine case or controversy exists.

III. COMMERCE CLAUSE CHALLENGE

A district court's judgment concerning a statute's constitutionality is reviewed de novo.[19] To the extent relevant to the constitutional question, subsidiary facts are reviewed for clear error.[20]

A statute violates the dormant Commerce Clause where it discriminates against interstate commerce either facially, by purpose, or by effect.[21] If the statute impermissibly discriminates, then it is valid only if the state "can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest."[22] If the statute does not discriminate, then the statute is valid unless the

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[18] *See Franklin v. Massachusetts*, 505 U.S. 788, 790-91 (1992) (finding redressability prong satisfied where actors who were not parties to the lawsuit could be expected to amend their conduct in response to a court's declaration).

[19] *Castillo v. Cameron County*, 238 F.3d 339, 347 (5th Cir.2001).

[20] *Maine v. Taylor*, 477 U.S. 131, 144-45 (1986).

[21] *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270, (1984).

[22] *C & A Carbone, Inc. v. Town of Clarkstown, N.Y.*, 511 U.S. 383, 392 (1994).

burden imposed on interstate commerce is "clearly excessive" in relation to the putative local benefits.[23]

A.

Allstate first attacks H.B. 1131 on the ground that the statute was passed with a discriminatory purpose. The company relies heavily on the legislative statements cited above in asserting that economic protectionism was the predominant motivation for the legislation.

The burden of establishing that a challenged statute has a discriminatory purpose under the Commerce Clause falls on the party challenging the provision.[24]

The Supreme Court has identified the following factors as relevant in determining whether purposeful discrimination animated a state legislature's action: (1) whether a clear pattern of discrimination emerges from the effect of the state action; (2) the historical background of the decision, which may take into account any history of discrimination by the decisionmaking body; (3) the specific sequence of events leading up the challenged decision, including departures from normal procedures; and (4) the legislative or administrative history of the state action, including contemporary statements by decisionmakers.[25]

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[23] *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

[24] *See Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).

[25] *See Village of Arlington Heights v. Metropolitan Housing Development Corp.*, 429 U.S. 252, 266-68,

Considering these factors, we conclude the district court did not clearly err in rejecting Allstate's contention that H.B. 1131 was purposefully discriminatory.

For one, Allstate and Sterling have failed to demonstrate a clear and consistent pattern of discriminatory action by the Texas Legislature. As discussed further below, while the effect of H.B. 1131 is to disadvantage Allstate, this effect derives solely from Allstate's status as the only body shop owning insurer in Texas. Allstate has failed to establish a history of hostility towards Allstate singularly or towards out-of-state companies in general.

Further, while characterizing the legislative hearings on H.B. 1131 as "perfunctory," Allstate has failed to show that the Legislature departed from usual procedures in its consideration or enactment of the bill. The Legislature held well attended committee hearings in both of its chambers where proponents for and against the measure were given comparable time to testify. In addition, there is no dispute that key legislators met with Allstate executives on several occasions, allowing the company to express its concerns about the bill. Indeed, these discussions produced a Senate amendment stripping a provision requiring complete divestiture of Allstate's ownership interest in Sterling.

(1977); *see also Waste Mgmt. Holdings, Inc. v. Gilmore*, 252 F.3d 316, 336 (4th Cir.2001) (applying Arlington Heights factors to dormant Commerce Clause analysis).

Finally, the stray protectionist remarks of certain legislators are insufficient to condemn this statute. Our independent review of the legislative record reveals that the Legislature heard extensive testimony from various witnesses on the legitimate consumer protection concerns sought to be remedied by H.B. 1131. For instance, legislators heard from several witnesses that vertical integration in the insurance business would create an inherent conflict of interest and an irresistible opportunity for insurers to engage in predatory practices.[26] They also heard that a system in which the insurance company and the body shop are aligned would eliminate the traditional checks and balances in the industry, meaning that the insurer's interest in keeping repair costs as low as possible would become the overriding interest.[27] Further, witnesses reported specific instances demonstrating these dangers.[28] This evidence provided a more than adequate and legitimate basis for the Legislature's decision to adopt the proposed regulations and undercuts Allstate's contention that the enactment of the overall statutory scheme was driven by a discriminatory purpose.[29]

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[26] H.B. 1131 House Hearing, supra note 4, pg. 5, 7.

[27] *Id.* at 8, 30, 100.

[28] *Id.* at 17-28, 30-31, 102, 104.

[29] *See Maine*, 477 U.S. at 150-51 (plaintiff's evidence, including statements made by state administrative agency expressing protectionist motivation for challenged legislation, would not establish violation of dormant Commerce Clause where evidence did not

Moreover, much of Allstate's evidence of "discrimination" towards out-of-state companies is simply evidence of a legislative desire to treat differently two business forms-independent auto body shops on the one hand and insurance-company-owned auto body shops on the other-a distinction based not on domicile but on business form. In *Ford v. Texas Department of Transportation,* we recently approved the Texas Legislature's enactment of an analogous statute based on this distinction.[30] In *Ford,* we upheld, against a dormant Commerce Clause challenge, a Texas statute which prohibited automobile manufacturers from acting as automobile dealers.[31] The plaintiff, Ford Motor Company, alleged that the statute violated the dormant Commerce Clause because it isolated Texas's retail car market and prevented the entry of out-of-state firms. Like the present case, the legislative history of the challenged provision in *Ford* revealed a legislative desire to prevent firms with superior market position (car manufacturers) from entering a downstream market (car dealership), a desire drawn from concern that vertical integration of the automobile market would be detrimental to consumers.[32] We held that because the challenged provision did not discriminate on the basis of a company's business contacts with the state, but rather on the basis of its status as an automobile

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demonstrate that the state had no legitimate interest in enacting the challenged regulation).

[30] 264 F.3d 493 (5th Cir.2001).

[31] *Ford,* 264 F.3d at 502.

[32] *See id.* at 500.

manufacturer, the statute did not offend the dormant Commerce Clause.[33] We find no significant factual or legal distinction between *Ford* and the instant case. Like *Ford,* the Legislature in this case sought to prevent firms with superior market position (insurance companies) from entering a downstream market (auto body repair) upon the belief that such entry would be harmful to consumers. The dormant Commerce Clause is no obstacle to such regulation.

B.

Next, Allstate and Sterling argue that H.B. 1131 has a discriminatory *effect* because it favors in-state body shops and will cause these services to shift from an out-of-state provider (*i.e.*, Sterling) to in-state providers. For this proposition, Allstate relies heavily upon *Exxon Corp. v. Maryland.*[34] In that case, various oil companies challenged the validity of a Maryland statute prohibiting producers and refiners of petroleum products from operating retail service stations in Maryland. The producers and refiners argued that the effect of the statute was to protect in-state independent dealers from out-of-state competition. They contended that the burden of the provision fell solely on interstate companies since Maryland had no in-state producers or refiners.[35] The Supreme Court rejected the

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[33] *Id.* at 502 (observing that out-of-state corporations which were non-manufacturers had the same opportunity as in-state corporations to operate in Texas).

[34] 437 U.S. 117 (1978).

[35] *Id.* at 125.

argument and in so doing, explained that merely because "the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce."[36] The Court observed that the challenged act "creat[ed] no barriers whatsoever against interstate independent dealers, [did not] prohibit the flow of interstate goods, place added costs upon them, or distinguish between in-state and out-of-state companies in the retail market."[37] The absence of these factors, the Court continued, "distinguishe[d] th[e] case from those in which a State ha[d] been found to have discriminated against interstate commerce."[38] While *Exxon* illustrates an unsuccessful dormant Commerce Clause challenge, Allstate relies heavily upon a footnote in the opinion in which the Court observed that "[i]f the effect of a state regulation is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market ... the regulation may have a discriminatory effect on interstate commerce."[39] Allstate argues that H.B. 1131 results in this precise effect.

Allstate's argument is unpersuasive. As an initial matter, H.B. 1131 does not require Allstate to shut any Sterling stores. Thus it is unclear how the new regulations would affect any shift in the current level of business presently enjoyed by out-of-state suppliers of body shops to in-state shops. However,

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[36] *Id.* at 126.

[37] *Id.*

[38] *Id.*

[39] *Id.* at 126, n. 16.

even if we were to assume that H.B. 1131 would act to reduce Sterling's ability to attract new business, which local body shops would then capture, this would still not establish a Commerce Clause violation. A state statute impermissibly discriminates only when it discriminates between similarly situated in-state and out-of-state interests.[40] Under H.B. 1131, as with the provision upheld in *Exxon,* similarly situated in-state and out-of-state companies are treated identically. Neither in-state nor out-of-state insurers may acquire a body shop and the statute raises no barriers whatsoever to out-of-state body shops entering the Texas market so long as they are not owned by insurance companies. Further, H.B. 1131 does not "prohibit the flow of interstate [services], place additional costs upon them, or distinguish between in-state and out-of-state companies in the retail market."[41] As the Supreme Court concluded under identical circumstances in *Exxon,* "[t]he absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce."[42]

The record does not support Allstate's bare allegation that business will shift from Sterling to

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[40] *Id.* at 126.

[41] *Id.*

[42] *Id.*; *Ford,* 264 F.3d 493 (where challenged provision did not "rais[e] the costs of doing business in the local market, strip[ ] away the economic advantages for an out-of-state participant, or giv[e] advantages to local participants[,]" it did not offend the dormant Commerce Clause).

in-state providers. The district court correctly concluded that Allstate failed to establish a dormant Commerce Clause violation where none of the hallmarks of past violations were present. Finally, that no Texas insurer is affected by the new regulation is of no consequence. The Supreme Court rejected the same assertion when offered in *Exxon* and this court has rejected similar arguments in the past.[43]

C.

The controlling question thus becomes whether, under *Pike*, "the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits."[44] A statute imposes a burden when it inhibits the flow of goods interstate.[45]

Allstate claims that H.B. 1131 inhibits the flow of goods interstate because it deprives Sterling of access to the Texas collision repair services market.

Again, Allstate's argument fails. The dormant Commerce Clause "protects the interstate market,

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[43] *Exxon*, 437 U.S. at 125; *Int'l Truck and Engine Corp. v. Bray*, 372 F.3d 717, 726 (5th Cir.2004) ("That all or most affected businesses are located out-of-state does not tend to prove that a statute is discriminatory."); *Ford*, 264 F.3d at 502 (finding it of no relevance that Texas had no motor vehicle manufacturers in challenge to law which limited ability of manufacturer's to engage in retail automobile sales).

[44] *Pike*, 397 U.S. at 142.

[45] *Ford*, 264 F.3d at 503.

not particular interstate firms."[46] The Supreme Court has "rejected the 'notion that the Commerce Clause protects the particular structure or methods of operation in a ... market.' "[47] While H.B. 1131 inhibits Sterling's ability to expand its auto body repair chain in Texas, the law does not prohibit other interstate repair chains or non-resident auto dealers not owned by insurance companies from operating in, or entering, the Texas market. Evidence was presented at trial showing that several interstate repair shops operate in the state.

Further, even if we were to characterize Sterling's inability to expand as a burden on interstate commerce, that burden would not be clearly excessive as compared to H.B. 1131's putative local benefits. In assessing a statute's putative local benefits, we cannot "second-guess the empirical judgments of lawmakers concerning the utility of legislation."[48] Rather, we credit a putative local benefit "so long as an examination of the evidence before or available to the lawmaker indicates that the regulation is not wholly irrational in light of its purposes."[49]

A reasonable legislator could have believed that H.B. 1131 would further legitimate interests in

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[46] *Exxon*, 437 U.S. at 127-28.

[47] *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 93-94 (1987) (quoting *Exxon*, 437 U.S. at 127).

[48] *CTS*, 481 U.S. at 92.

[49] *Ford*, 264 F.3d at 504 (quoting *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 680-81 (1981)).

protecting consumers. As discussed above, House and Senate committees heard extensive testimony on the dangers of insurer-owned body shops. A legislator could reasonably have believed that a ban on the targeted business form would further Texas's legitimate interests in consumer protection. That reasonable belief is enough to confirm that H.B. 1131 has at least putative local benefits.[50] Allstate has not established that the burden on one interstate firm constitutes a burden on interstate *commerce* that clearly outweighs these local benefits.

Because we conclude H.B. 1131 does not violate the dormant Commerce Clause, we need not consider the State Defendant's alternative argument that McCarran-Ferguson Act removes this regulation from the reach of the dormant Commerce Clause.

IV. FIRST AMENDMENT CHALLENGE

Alleged violations of free speech present a mixed question of fact and law that is reviewed de novo.[51]

Allstate challenged in the district court the following provisions of H.B. 1131 as violations of the First Amendment's protection of truthful and non-deceptive commercial advertising:

- Tex. Occ. Code § 2306.006(3), which prohibits an insurer from engaging in a joint marketing program with a tied repair facility.

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[50] *See Int'l Truck*, 372 F.3d at 729.

[51] *LLEH, Inc. v. Wichita County, Tex.*, 289 F.3d 358, 364-65 (5th Cir.2002).

- Tex. Occ. Code § 2306.006(4), which prohibits an insurer from providing to tied repair facilities a recommendation, referral or description not provided on identical terms to other preferred repair facilities.
- Tex. Occ. Code § 2306.006(6), which prohibits allowing a tied repair facility to use an insurer's name in a manner different from that allowed for any other facility with which the insurer has a referral arrangement.
- Tex. Occ. Code § 2306.006(9), which prohibits an insurer from recommending that policyholders have their vehicles repaired at tied repair facilities, except to the same extent it recommends other repair facilities with whom the insurer has entered into a referral arrangement.

These regulations apply to the existing Sterling stores which are authorized to continue operation in Texas after enactment of H.B. 1131. The district court upheld Allstate's First Amendment challenge.

The First Amendment, as applied to the states through the Fourteenth Amendment, generally protects commercial speech from unwarranted governmental regulation where the speech is not false, deceptive, or misleading.[52] In *Central Hudson Gas & Electric Corp., v. Public Service Commission of New York,*[53] the Supreme Court articulated a test for determining whether a particular commercial

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[52] *Zauderer v. Office of Disciplinary Counsel,* 471 U.S. 626, 628 (1985).

[53] 447 U.S. 557 (1980).

speech regulation is constitutionally permissible. Under that test, a court asks as a threshold matter whether the commercial speech concerns unlawful activity or is misleading. If so, then the speech is not protected by the First Amendment. If the speech concerns lawful activity and is not misleading, however, a court next asks whether the asserted governmental interest is substantial. If it is, then a court determines whether the regulation directly advances the governmental interest asserted, and, finally, whether it is not more extensive than is necessary to serve that interest.[54] Each of these latter three inquiries must be answered in the affirmative for the regulation to be found constitutional.[55]

A.

The State Defendants first attempt to defend H.B. 1131's speech provisions under the first prong of the *Central Hudson* test, i.e., they argue that the prohibited advertisements concern (1) unlawful activity or (2) misleading speech.

1. Does H.B. 1131 prohibit advertisements about unlawful activity?

The State Defendants claim that the speech restraints are valid because they are merely incidental to H.B. 1131's provision which requires insurers and their collision repair subsidiaries to negotiate at "arm's length." The State Defendants attempt to analogize this case to *Ford*, in which we

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[54] *Thompson v. Western States Med. Ctr.*, 535 U.S. 357, 367 (2002).

[55] *Id.*

upheld a state law restricting car manufacturers from advertising cars for sale on their websites. In that case, we explained that because the regulation was only incidental to Texas's general prohibition against manufacturers selling automobiles at retail, it was not entitled to the protection of the First Amendment.[56]

The instant case is distinguishable from *Ford*, where the challenged speech regulation sought to prevent a manufacturer from advertising a product it was strictly prohibited by law from selling. Unlike that case, H.B. 1131's speech provisions are not incidental to the regulation of activity made illegal by Texas law. Prohibiting Allstate from giving an exclusive recommendation to a Sterling body repair shop does not help ensure that the two entities are operating at arm's length. Similarly, an arm's length transaction may very well include a negotiated agreement in which an insurer agrees to recommend one body shop exclusively to its customers. Indeed, this is roughly the deal that various auto body shops enrolled in the PRO program have struck with Allstate. Because H.B. 1131 does not make it illegal for Allstate to have a business affiliation with Sterling, there is no legal prohibition preventing Allstate from communicating that relationship to customers.[57]

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[56] *Ford*, 264 F.3d at 506.

[57] *See id.* (noting that if challenged speech regulation prohibited advertising a commercial activity lawful in Texas, the regulation would invoke the protections of the First Amendment and be subjected to *Central Hudson*).

2. Does H.B. 1131 prohibit advertisements which would be misleading?

The State Defendants alternatively seek to uphold H.B. 1131's regulations to prevent false and misleading representations, such as the Allstate script's recommendation of Sterling. The State Defendants argue that the implication of the script is that Sterling is the best available auto body repair service in terms of services offered and quality of repair, an implication that is not true. The State Defendants also contend that the Allstate script is misleading because it suggests a link between Allstate and Sterling that would give customers utilizing Sterling pricing or other advantages that are prohibited by Texas law.

The State Defendants' rationale for finding a script which recommends only a tied body shop "false and misleading" is unpersuasive. While it may be that a recommended tied body shop does not enjoy as good a reputation for quality work as other body shops, a recommendation to that shop does not involve an inherently false or misleading representation. This characterization is particularly inapt when applied to Allstate's script, which informs customers of the Allstate/Sterling affiliation at the outset of the pitch, and thus gives customers the option of discounting the recommendation and puffing. Further, the evidence revealed that the majority of Allstate's customers choose *not* to have their vehicle repaired by Sterling. This is certainly persuasive evidence that an exclusive recommendation does not necessarily mislead consumers into believing that Sterling is far superior to other facilities nor that utilization of the recommended shop is required. Unlike the situation

in the principal case relied upon by the State Defendants, *Zauderer v. Office of Disciplinary Counsel*,[58] the potential for customer confusion here is minimal. We agree with the district court's conclusion that the Allstate script is neither false nor misleading. In light of this conclusion, we turn to the remaining prongs of the *Central Hudson* test.[59]

B.

Under *Central Hudson*, after the threshold inquiry, a court must determine whether (1) the state has a substantial interest in regulating the speech; (2) the restriction on speech directly advances the state interest involved; and (3) the state's interest could be equally well served by a more limited restriction on commercial speech.[60]

1. Is there a legitimate state interest?

The State Defendants have successfully asserted a legitimate interest in consumer protection and the promotion of fair competition.[61]

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[58] 471 U.S. 626 (1985) (rejecting First Amendment challenge to the application of state rule against deceptive advertising where attorney advertisement was likely to mislead average customer).

[59] *See Ford*, 264 F.3d at 506 (if a challenged speech provision prohibits advertising a lawful commercial activity, the regulation is subject to intermediate scrutiny outlined in *Central Hudson*).

[60] *Central Hudson*, 447 U.S. at 566.

[61] *See Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447, 460 (1978) (state clearly has an interest in consumer protection).

2. Does the regulation directly and materially advance the State's asserted interest of benefiting consumers and ensuring fair competition?

As the district court persuasively explained, the State advances no legitimate interest in preventing non-misleading and truthful referrals to a tied body shop:

> Consumers benefit from more, rather than less, information. Attempting to control the outcome of the consumer decisions following such communications by restricting lawful commercial speech is not an appropriate way to advance a state interest in protecting consumers. *Thompson v. Western States Med. Ctr.*, 535 U.S. 357, 374 (2002).

H.B. 1131's speech provisions do not require that customers be informed of a insurer/body shop arrangement or the existence of a law against steering, regulations which would arguably reduce the potential for consumer confusion. Rather, the challenged provisions only prevent an insurer from recommending its tied body shop to customers. This would encourage business to shift away from the tied shop but it would not protect consumers, who may or may not choose to use a tied shop even after being informed of its advantages, and who may have a good rather than bad experience if they do choose to use a tied shop.[62] If the work performed on customer

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[62] *See Central Hudson*, 447 U.S. at 562 ("Commercial expression not only serves the economic interest of the speaker, but also assists consumers and furthers the societal interest in the fullest possible dissemination of information.... People will perceive

vehicles at a tied body shop is shoddy, aggrieved customers are free to pursue legal and administrative remedies. Ultimately, the State Defendants have not shown that restricting the truthful speech about the benefits of using a tied auto body repair shop benefits customers.[63] Notably, Allstate's challenged script gives customers notice of the affiliation between itself and Sterling and further informs them that "[they] are always free to choose any repair shop of [their] choice and are under no obligation or requirement to use a shop [Allstate] recommend[s]...." These statements offer ample protection against the danger of consumer confusion.

Moreover, on the issue of fair competition, it is not clear how requiring the insurer to recommend at least one other body shop in the PRO program in addition to its tied shop-but not all shops-promotes fair competition. While this widens the circle of advantaged shops, it does not ensure overall fair competition for all body shops.

3. Is the restriction narrowly tailored to the state interests advanced?

Our analysis of the first three *Central Hudson* prongs leads us to conclude that H.B. 1131's commercial speech provisions are not narrowly

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their own best interests if only they are well enough informed, and the best means to that end is to open the channels of communication rather than to close them.") (internal alterations and citation omitted).

[63] *See id.* at 567 (suppression of advertising reduces the information available for consumer decisions and is contrary to the purpose of the First Amendment).

tailored to meet the asserted state objectives. It is well established that the party seeking to uphold a restriction on commercial speech carries the burden of justifying it.[64] The State Defendants here fail to demonstrate why a more limited restriction, such as a requirement that Allstate disclose its ownership of Sterling or inform customers of Texas's anti-steering law, would not have adequately served the state's interest in consumer protection.[65] Moreover, the State Defendants have not explained how compelling Allstate to provide a referral to at least two body shops would have a positive effect on overall competition or why requirements similar to those we have alluded to above would be any less effective in promoting such ends.

C.

The State Defendants finally contend that while Allstate's script may provide an occasion for a successful as-applied challenge to certain provisions of H.B. 1131, the district court erred in declaring those provisions facially invalid.

We disagree. It is not the content of the specific Allstate script at issue which guides our analysis above, but rather the failure of the State Defendants to suggest a single circumstance in which these provisions, which ban non-misleading and truthful advertising, could be constitutionally applied. The

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[64] *Thompson*, 535 U.S. at 373.

[65] *See Central Hudson*, 447 U.S. at 571 ("In the absence of a showing that more limited speech regulation would be ineffective, we cannot approve the complete suppression of [plaintiff]'s advertising.").

Supreme Court has recently invalidated provisions containing similar blanket bans on advertising.[66]

V. CONCLUSION

For the foregoing reasons, we AFFIRM the judgment of the district court.

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[66] *See Thompson*, 535 U.S. at 371-77 (declaring invalid a provision of the Food and Drug Administration Modernization Act of 1997 which prohibited pharmacists from advertising certain types of patient customized drugs where Government failed to demonstrate that the speech restrictions were not more extensive than necessary to serve its asserted interest in public health; "if the Government [can] achieve its interest in a manner that does not restrict speech, or that restricts less speech, the Government must do so."); *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996) (striking down state ban on all advertisements containing information about the price of alcohol; state failed to satisfy heavy burden under *Central Hudson* of justifying a complete ban all ads that contain accurate and non-misleading information); *see also Secretary of State of Md. v. Joseph H. Munson Co., Inc.*, 467 U.S. 947 (1984) ("Where ... a statute imposes a direct restriction on protected First Amendment activity, and where the defect in the statute is that the means chosen to accomplish the State's objectives are too imprecise, so that in all its applications the statute creates an unnecessary risk of chilling free speech, the statute is properly subject to facial attack.").

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

ALLSTATE INSURANCE CO. and STERLING COLLISION CENTERS, INC.,	§	
Plaintiffs,	§	
v.	§	Civil Action No. 3:03-CV-2187-K
GREG ABBOTT, in his official capacity as Attorney General of Texas, CAROL KEETON STRAYHORN, in her official capacity as Texas Comptroller of Public Accounts,	§	
Defendants,	§	
AUTOMOTIVE SERVICE ASSN. and CONSUMER CHOICE IN AUTOBODY REPAIR,	§	
Intervenors.	§	

FINDINGS OF FACT
AND CONCLUSIONS OF LAW

This case involves a dispute between Allstate Insurance Co. and Sterling Collision Centers, Inc. as Plaintiffs, Greg Abbott and Carol Keeton Strayhorn as Defendants in their official capacities as Attorney General of Texas and Texas Comptroller of Public

Accounts, and the Automotive Service Association and Consumer Choice in Autobody Repair as Intervenors. Plaintiffs challenge a Texas law known as House Bill 1131 (codified as Tex. Occ. Code § 2306.002) as a violation of their rights to free commercial speech, and under the dormant commerce clause of the United States Constitution. The law generally prohibits insurance companies from owning a financial interest in autobody repair facilities. In these findings of fact and conclusions of law, the court will refer to the statute as H.B. 1131, as the parties have done throughout this litigation.

After a hearing held in November 2003, the court entered a preliminary injunction preventing the enforcement of H.B. 1131's speech restrictions. This matter then came before the court for a bench trial that was completed in October 2004. Having received and considered the evidence presented, and having heard the testimony of witnesses and the argument of counsel, the court finds that H.B. 1131 is constitutional, except for subsections (3), (4), (6) and (9) of Tex. Occ. Code § 2306.006, which violate the First Amendment of the United States Constitution. The court hereby renders the following Findings of Fact and Conclusions of Law. As permitted by Federal Rule of Civil Procedure 52(a), the court sets out its findings and conclusions as follows:

I. Findings of Fact

A. The Parties

1. Plaintiff Allstate Insurance Company ("Allstate") is an automobile insurer holding a market share of approximately 13% nationally and 15% in the state of Texas.

2. Plaintiff Sterling Collision Centers, Inc. ("Sterling") is a wholly-owned subsidiary of Allstate Non-Insurance Holdings, Inc., an indirect affiliate of Allstate. Sterling is a multi-state chain of collision repair facilities.

3. Defendant Greg Abbott ("Abbott") is the Attorney General of the State of Texas, and is being sued in his official capacity as an officer charged with the enforcement of Texas statutes.

4. Defendant Carol Keeton Strayhorn ("Strayhorn") is being sued in her official capacity as Comptroller of Public Accounts. Under Texas law, the Comptroller has authority to deposit civil penalties in the Texas general fund. Because the statute at issue in this case authorizes civil penalties, Strayhorn's role in enforcing and depositing such penalties depends upon the constitutionality of H.B. 1131.

5. Intervenor Automotive Service Association ("ASA") is a national organization of autobody shops.

6. Intervenor Consumers for Choice in Autobody Repair ("CCAR") is a group formed contemporaneously with the lobbying effort to pass H.B. 1131.

B. The Role of Insurance Companies in the Collision Repair Market

7. Due to the prevalence of automobile insurance, and the numerous state laws requiring motorists to maintain insurance, insurance companies play a significant role in funding automobile repairs. Insurance companies pay for approximately 90% of all collision repairs.

8. In many cases, the insurance company is the first point of contact for a customer after a collision.

Allstate's consumer surveys confirmed that "because individuals typically do not know what to do after an automobile accident or where to take the car for repair, they frequently expect to get information from their agent." Allstate's consumer surveys further state that "an agent's recommendation holds a lot of weight with customers. Many say they have built a relationship over time and trust the agent's recommendation." As a result, insurance companies have the ability and market power to exert substantial influence and control over where its customer will take a wrecked car for repairs.

9. The role of the insurance company in the repair market creates tension, because there is an inherent conflict of interest between the insurance company's desire to make a profit for its shareholders, and thus to keep its costs of repair low, with the insurance company's obligation to provide its insured with a high quality and safe repair in accordance with the terms of its applicable insurance contracts.

10. The conflict between the insurance company and its customer has materialized on many levels, and is illustrated by the push to use non-OEM parts in connection with autobody repairs. OEM parts are "original equipment manufacturer" parts that are the same parts manufactured and used on a vehicle as originally built by the manufacturer. Often, however, repair shops use non-OEM parts, which include salvaged parts, recycled parts, used parts, and parts manufactured by third parties other than the original equipment manufacturer. OEM parts tend to be a better fit into a vehicle because those parts are the ones specifically designed for a particular vehicle. Non-OEM parts may not fit correctly, and often require significant time and

effort to modify the parts for use in a vehicle. OEM parts are often of a higher quality, and may have a longer life span. But, OEM parts generally cost more than non-OEM parts.

11. Vehicle owners and repair shops often prefer to use OEM parts due to their better fit and quality. As a result, there is a natural tension between the interests of the insurance company and the consumer.

12. At trial, Allstate and Sterling contended that Sterling gives its customers the right to choose the type of parts that will be used to repair that customer's vehicle. On the authorization form completed by Sterling's customers, the choice that Sterling actually gives its customers is a choice between "Aftermarket Crash Parts" and "OEM Crash Parts." This form does not give Sterling's customers the option to require the use of new OEM parts for the repair of their cars.

C. Allstate's Role in the Collision Repair Services Process

13.The claims settlement process significantly impacts Allstate's ability to compete in the auto insurance market. Claims costs represent a large majority of an insurer's expenditures. Allstate pays approximately $5 billion in auto repair claims annually. These costs impact insurance premiums.

14. Allstate says consumer surveys indicate that a policyholder's experience with the claims process is integral to overall policyholder satisfaction. Although Allstate has not shown the court the actual survey results, a summary of these surveys provided by Allstate shows that a strong relationship exists between claims satisfaction and rates of policyholder

defection to other insurance carriers. However, Allstate's research also shows that completely satisfied claimants are still the majority of policyholders who "defect" to another insurance carrier.

15. Claims handling satisfaction is important to Allstate because 90 percent of its auto insurance business comes from policyholders who renew their policies with Allstate.

16. To encourage policyholder renewals, Allstate wants to ensure that its policyholders are satisfied with the entire claims process and that the process runs as smoothly and efficiently as possible.

17. For repairable vehicles, Allstate policyholders may choose to accept payment from Allstate for the reasonable cost of the repair (allowing the customer to either retain the money or choose a shop of his or her choice) or go to a recommended collision repair shop with which Allstate has an ongoing relationship. For this latter form of settlement, Allstate becomes the direct purchaser – and payor – for the repair services.

18. Regardless of the outcome of this case, policyholders will still be able to choose either option.

19. By obtaining efficient, high-quality repairs, Allstate is able to satisfy its claimants and compete effectively in the car insurance market.

D. Allstate's Experience in the Collision Repair Market

20. Allstate's single largest operating cost as an automobile insurer is the cost of auto collision and accident repairs.

21. The interests of autobody repair shops and insurance companies are often in conflict, because the collision repair shops must make a profit, whereas insurance companies are trying to minimize costs while guaranteeing that their customers are satisfied with the repairs. This situation can lead to collision repair fraud.

22. According to Allstate, collision repair fraud occurs most often in the following ways:

- Repairing an autobody part, yet charging for a replacement part;
- Charging for one type of part, like an OEM part, but instead installing a less expensive or salvaged part;
- Charging for labor and services not provided;
- Charging for repairing non-existing damage; and
- Charging for repairing pre-existing damage.

23. Detection of such fraud and waste is difficult, expensive, and ineffective. Fraudulent repairs of a vehicle may not surface immediately. An owner may be unaware that his or her vehicle is improperly repaired due to his or her lack of knowledge of car repair, or the fact that some improper repairs do not manifest themselves right away.

24. Collision repair waste and fraud hurts both consumers and insurance companies. Inflated claims costs hurt the insurers, who pay for waste and fraud, and the policyholders, who see their premiums rise.

25. In addition to issues related to waste and fraud, Allstate also was concerned about the high levels of

customer dissatisfaction with the collision repair industry. Industry studies have found common complaints include repairs that take too long, cost too much, and lack in quality. Allstate's internal marketing research revealed that over twenty percent of policyholders are dissatisfied with their collision repair experience.

26. Claimants routinely complain to Allstate about poor repair quality.

27. Claimants value fast turnaround on autobody repairs.

28. Some of the smaller autobody repair shops do not track timeliness of repairs.

29. Customer dissatisfaction also arises from body shops' failure to adhere to consistent quality control processes.

30. Many body shops have no established quality control procedures.

E. Inefficiencies Allstate Faced in the Autobody Repair Market

31. Nationwide, Allstate's experience with autobody repairs was that repairs were inefficient because local repair shops gave cost estimates that were too high, concerns about fraudulent work were present, and the local body shops did not employ efficient techniques in the division and specialization of labor.

32. Allstate believed repairs done through local body shops were less efficient than they could be, because these shops lacked state-of-the-art equipment that would permit a higher volume of repairs, thus spreading the fixed cost of repairs over a larger base and lowering the cost of repairs per car.

33. Allstate found that independent repair shops had no incentive to provide speed and quality of repairs to a one-time customer, because they were being paid for repairs at cost-plus pricing on parts and a flat hourly rate for labor. Therefore, these shops had no economic incentive to save time.

F. The PRO Program

34. Allstate and other insurers have attempted to combat waste and fraud by autobody repairers through complex systems of review and monitoring of repair estimates. Even with these efforts, it is difficult to systematically identify waste and fraud in this manner, because the damage to each car is different and there are thousands of different makes and models of vehicles on the road. Attempting to combat waste and fraud this way also causes insurers to incur significant monitoring costs.

35. Believing that fraud by various autobody shops engaged to perform those repairs was inflating autobody repair expenses substantially, Allstate instituted a number of programs designed to combat and reduce such fraud, including an inspection system to detect shoddy or unnecessary repairs.

36. Both prior to and after Allstate's acquisition of Sterling, Allstate has had preferred provider agreements with various independently owned and operated autobody repair facilities. Using these preferred facilities was an effort to identify the shops with the best repair techniques both in quality and timeliness of repairs.

37. These facilities provided repairs to Allstate policyholders through Allstate's Priority Repair Option or "PRO" program.

38. The PRO program is a "Direct Repair Program" developed by Allstate in the 1970s.

39. Allstate found that many consumers sought its advice as to where to get their cars repaired. Therefore, the PRO program was established as a direct relationship between Allstate and body shops, through which Allstate recommends body shops to its insureds and claimants.

40. Allstate's recommendations through the PRO program led to higher volume for the recommended shops.

41. Although the PRO program was an effort by Allstate to resolve the inefficiencies caused by using independent autobody repair shops to repair its customers' cars, it has failed to completely resolve the problem. Even though Allstate provided the PRO shops with a greater volume of cars to repair, only modest increases in efficiency were achieved.

42. Allstate found that at PRO shops who received more than four Allstate estimates per week, and where more than 20 percent of the shops' total repair volume came from Allstate insured cars, the average cost to repair a vehicle at those shops was four percent lower than at other shops.

43. By early 2000, Allstate had concluded that insurer volume arrangements like the PRO program, which were a simple volume promise in exchange for discounts, only provided marginal benefits. Also, those agreements did not spur the development of large, modern and efficient repair shops, since the PRO shops were hesitant to make large capital investments for fear of losing key insurer relationships, which apparently lacked long term agreements.

44. Therefore, Allstate decided to explore other alternatives in addition to the PRO program.

G. Allstate's Acquisition of Sterling

45. Allstate felt that it had achieved maximum efficiencies through the PRO program and monitoring, but still wanted to achieve further reductions in costs and to provide the customer with a high-quality, quick, cost-effective and hassle-free car repair.

46. Allstate believes only nationwide repair shops or automobile manufacturers could achieve this goal of a lower cost, faster and consistently high quality autobody repair.

47. Allstate thought autobody repair costs could be reduced by building "greenfields" – modern assembly line type operations that would provide cost savings through a nationwide network of buying power and a nationwide standard of quality and timeliness in completion of repairs.

48. After a comprehensive review of its claims settlement strategy in 2000, Allstate concluded that it could gain a competitive advantage for itself and its policyholders by deepening its relationships with autobody shops. Allstate thus explored a new strategy: the creation of a large Allstate-owned interstate collision repair chain that would improve the car repair business for the benefit of Allstate's customers, and thereby enhance the Allstate brand.

49. Allstate reviewed and evaluated several interstate autobody repair consolidators, including ABRA, AutoNation, the Boyd Group, Caliber, CTA, True 2 Form, and M2, as well as Sterling.

50. To achieve its goal of a lower-cost, higher-quality autobody repair, Allstate bought Sterling in 2001.

Sterling operates approximately 60 autobody repair shops in 14 states, including 15 shops in Texas.

51. As of 2001, Sterling had been in business for four years. From the beginning, Sterling focused on its "team" approach to autobody repairs, under which multiple technicians would work on a single vehicle. Sterling also created flow processes through which it believed it could provide a more efficient and timely repair process.

52. The "Sterling model" for collision repair was implemented long before Allstate purchased Sterling. The purported Sterling benefits, including guaranteed completion dates, lifetime guarantees, clean vehicles, and "kaizen zero" events all existed before Allstate purchased Sterling.

53. After Sterling was formed in 1997, its initial growth was by acquisition of existing non-assembly line "Mom and Pop" body shops (known as "brownfields"). Sterling's first 32 shops were added to the chain through acquisition. However, Sterling found that the acquisition of existing shops gave rise to inefficiencies, and wasted expense. Sterling also inherited preexisting customer service issues from some of these shops.

54. Sterling found it difficult to integrate the differing brownfield operations to form one efficient network, and it was expensive to acquire the brownfield shops because it had to pay for existing good will and customer volume. By the time the shops were converted from typical local body shops to a piece of a large network, the value of the acquisitions were diminished.

55. Sterling then migrated to building new shops (known as "greenfields") rather than acquiring them.

Greenfields were new shops that relied on the team model and assembly line efficiencies to achieve savings and quality.

56. Under the greenfield model, Sterling would identify markets, population centers where the company could be relatively confident there would be sufficient repair volume. The new repair shop would be built and outfitted with state-of-the-art equipment and employees would be trained "the Sterling way" through Sterling's training programs. Managers would be trained in Sterling management processes.

57. Each new greenfield shop opened by Sterling required a sizeable capital investment and a new book of business. For Sterling alone, entering the market with this business model was difficult, because it did not have the volume of business associated with insurer referrals.

58. After the purchase of Sterling in 2001, Allstate has provided Sterling with the needed capital and a supply of customers. Allstate's Richard Bledsoe admitted that Sterling employees have an incentive to keep Allstate happy.

H. Allstate Attempts to Combat Inefficiency Through Sterling

59. By acquiring Sterling, Allstate intended to take advantage of the economies of scale that were available in the Sterling shops. The Sterling shops are larger than typical independently owned and operated autobody repair shops, and therefore offer advantages and economies of scale provided by things like modern, state-of-the-art equipment, specially trained technicians who can be dedicated to specific types of repairs, load leveling (a practice in

which cars are moved from one repair facility to another, allowing Sterling to efficiently manage capacity, thus avoiding downtime or delays in completing repairs), and spreading administrative labor costs (which do not increase proportionally with shop size) over a broader base. Additionally, Sterling shops employ a team model, where specialized technicians each repair part of the car, moving the vehicle through a multi-step process and using skilled labor efficiently.

60. Much of the state-of-the-art equipment used at Sterling is expensive. Allstate has invested more than $2.6 million per shop in order to keep Sterling up to date with such equipment and further upgrade Sterling's facilities.

I. Allstate's Communications With its Customers Regarding Sterling

61. Allstate believes that consumers care about having a repair option such as Sterling because they desire quality repairs, faster service and lower premiums.

62. After its acquisition of Sterling, Allstate implemented the following script to be used for policyholder calls regarding autobody repairs: Mr./Mrs._____, of course you are always free to choose any repair shop and are under no obligation or requirement to use a shop we recommend, however, I would like to make you aware of the benefits of Sterling Autobody Centers, which are affiliated with the Allstate Corporation. Sterling Autobody Centers are highly respected and provide exceptional customer service. Sterling provides a lifetime guarantee as long as you own your vehicle on both parts and labor. In addition, they will handle all the paper work, keep you

updated throughout the repair process, guarantee a completion date, and, even, professionally clean your vehicle inside and out. They can also assist with rental arrangements on site and will pay for additional rental expenses if the guaranteed delivery date is missed.

63. Although Allstate has utilized this script to promote and encourage policy holders to try Sterling, Sterling holds less than 5% of the collision repair market in Texas.

64. Both Sterling and PRO shops provide a lifetime guarantee on parts and labor for so long as the policyholder owns his or her car.

65. Sterling shops also provide customers with a guaranteed completion date, clean the customer's vehicle both inside and out, and will pay for additional automobile rental expenses, if its guaranteed delivery date for the customer's car is missed.

66. Although some of the PRO shops also provide some of these additional benefits, they are not uniformly provided by PRO shops.

67. Following the acquisition of Sterling, Allstate began using the above script to first offer the services of the Sterling shops to its policyholders, without offering its PRO shops directly to the customer as it had previously.

68. The PRO program has continued, but Allstate continues to refer policyholders to PRO shops only when asked.

69. Allstate also features the PRO program on its website, immediately under the information regarding Sterling.

70. Like the script it uses in telephone calls, Allstate's website makes clear to customers that they are also free to use the repair shop of their choice, if they do not want to use either Sterling or the PRO program shops.

71. The court finds that Allstate's script is not false or misleading. From the script, it is clear to Allstate's customers that they are free to use any autobody repair shop they choose. It is also clear from the script that Allstate is advertising Sterling's services because Allstate is affiliated with Sterling.

72. The legislative history to H.B. 1131 shows no claim that Allstate's speech regarding Sterling is deceptive or untruthful.

73. There is no evidence that any consumers have been deceived by the speech H.B. 1131 regulates.

J. Allstate Struggles to Make Sterling Successful

74. Currently, approximately 60% of Allstate's policyholders choose *not* to have their cars repaired by Sterling, even when Sterling is offered.

75. Although Allstate anticipated increased customer satisfaction with Sterling, an Allstate consumer follow-up survey conducted in 2002 showed that overall, consumers were less satisfied with Sterling than non-Sterling repairs. In May 2003, Allstate admitted that it had "hard evidence" of quality issues related to Sterling. Despite its awareness of these customer satisfaction and quality problems, Allstate continued to refer its policyholders to Sterling.

76. At trial, Allstate and Sterling attempted to downplay the impact of these quality issues, blaming the problems primarily on the brownfield stores,

versus the newer greenfield stores. However, when promoting Sterling to customers, Allstate made no distinction between brownfield and greenfield stores and continued to refer customers to Sterling without regard to the quality and performance of the particular shop recommended.

77. Undeterred, Allstate continued to try and improve Sterling's operations. Allstate and its consultants analyzed the market, particularly with reference to other collision repair shops with whom Allstate did business, to determine how to adjust Sterling's costs and processes. Sterling's Mr. Daly testified:

> Q. So what you do is go to the PRO marketplace and find this average or find this benchmark, however, you do it and you want to call it, and then you take the information over and then that's what Sterling charges.
>
> A. That's right.

Through its PRO program, Allstate had access to significant information from Sterling's competitors, including information regarding technician pay, labor costs, hours worked on a repair, profits, and the cost of parts and repairs. Sterling's competitors, such as Herb's, do not want Allstate to share their business information with Sterling to help Sterling make decisions on how to compete against them.

78. Allstate used confidential information obtained from PRO shops to make decisions as to how Sterling should run its repair shops. For example, Allstate maintained its "Paris" database, which included significant pricing information relating to PRO

shops. That information includes data down to the specific claims paid by Allstate to its PRO shops.

79. Allstate used that information to compare PRO shop performance to Sterling's performance as part of its ongoing efforts to improve operations at Sterling. Indeed, Allstate even shared the information in the Paris database with Sterling leadership, meaning that Sterling was receiving the benefit of adjusting its operations based upon information Allstate knew about Sterling's competitors. Senator Carona identified this practice and the ability to share confidential information with Sterling as a type of anti-competitive conduct that he intended to prohibit through H.B. 1131.

80. Of course, Allstate did not share the same sensitive business information about Sterling or the market with any of Sterling's competitors. Indeed, in this case, Allstate and Sterling insisted on a strict protective order that precludes Sterling's competitors from seeing much of the information produced in this lawsuit.

81. To increase opportunities for referral to Sterling shops, Allstate removed some independent repair shops from its PRO network. For example, in September 2001, an Allstate representative stated that Allstate had "dialed down some fairly large PRO players that surround the North Houston stores as a first attack on volume." Other PRO shops were also eliminated from the PRO program because of their location close to a Sterling shop.

82. For example, Herb's Paint & Body Shop in Garland, Texas, which had a high customer approval rating, was one such victim after a Sterling shop opened less than one mile away.

83. Larry Stafford, the owner of RiverCity Collision, Inc. in Austin, Texas, was informed that his repair shop was being removed from the PRO network because, in the words of a local Allstate representative, his shop was located in the "circle of death."

84. Sterling's CEO Jon McNeill also emphasized that Allstate needed to "right-size" the number of PRO shops located within 10 miles of Sterling shops in order to increase business for Sterling and make the Allstate-Sterling relationship successful. In April 2002, McNeill stated that:

> the next chronological step is the right-sizing of PRO within 10 miles of Sterling stores. This step is critical, but also painful in the local market. It can't be avoided though as this step has the single most positive impact on volume.

Sterling's Mr. Daly also admitted that adjustments were made to PRO to increase Sterling's volume of business:

> Q. To ensure the viability of the Sterling business you had to make adjustments? That means you took PRO shops out?
>
> A. In some cases, in some markets.

85. When Allstate reduced the size of its PRO network, Allstate did not remove any Sterling stores from that network, even when those shops experienced quality problems. Allstate placed its own financial interests in Sterling above those of its policyholders who often turned to Allstate for guidance and recommendations about where to take their vehicles for repair following an accident.

K. Vertical Integration Between Insurers and Repair Shops Creates a Conflict of Interest That is Harmful to Consumers

86. Allstate and Sterling have stated that their goal was to align the incentives between insurance companies and repair shops to provide lower cost repairs. Evidence and experience have shown that aligning those incentives places the repair shop in the unfortunate position of having to decide whether to be an advocate for the accident victim (its customer) or an arm of the insurance company keeping the costs of repair down. Thus, vertical integration of an insurance company into the autobody repair industry creates an inherent conflict of interest.

87. The consumers Allstate surveyed before acquiring Sterling in 2001 informed Allstate of this very issue. They were concerned that Allstate ownership of autobody repair facilities would lead to a situation in which Sterling would place Allstate's financial interests ahead of those of Sterling's customers. Consumers were concerned about repair shops cutting corners to save repair costs at the request of their parent insurance company.

1. Edmundo Fulgencio

88. At trial, Defendants and Intervenors offered evidence regarding Edmundo Fulgencio's experience with Sterling. Fulgencio purchased a new Dodge truck from Goodson Dodge in Houston in 2001. Goodson Dodge is owned by United Auto Group, an interstate chain of car dealerships that operates many collision repair shops. Shortly after purchasing the new truck, Fulgencio was involved in an accident. The driver who hit Fulgencio in that accident was insured by Allstate. Fulgencio brought

his truck to Goodson's collision repair center, and Allstate covered the costs of his repairs.

89. Fulgencio was involved in a second accident in January 2003. Fulgencio was insured by Allstate, who recommended that he use Sterling's West Little York store in Houston for the repair. Sterling's West Little York location had received failing marks for repair quality in an internal audit Allstate conducted in August 2002.

90. Initially, Fulgencio inquired about having his truck repaired at Expert Collision Repair, an independent autobody shop near his home; however, that shop advised him that it would not be able to start work on his vehicle for approximately two weeks. Fulgencio then decided to use Sterling.

91. When Fulgencio went to pick up his vehicle from Sterling, he noticed that not all of the repairs were complete. After driving the truck, he believed it was out of alignment. He told store manager Jana Ordonez that he was unhappy with the repairs and asked why Sterling had not done all the repairs needed. Ordonez replied that Sterling had done all the repairs authorized by Allstate and that it was not up to her what repairs should be done. According to Ordonez, she could do nothing more for him. Ordonez referred Fulgencio to Steve Dunn, Allstate's field inspector.

92. Ultimately, Rick van Boxtel, the owner of Expert Collision Repair, inspected Fulgencio's vehicle and assisted in explaining to Sterling the repairs that were still needed. Sterling continued trying to repair Fulgencio's truck, but eventually admitted they could not fix the alignment and authorized Fulgencio to take his truck elsewhere for repairs. Ordonez

stated that Sterling would pay the shop of Fulgencio's choice for those repairs.

93. Fulgencio took his truck to Expert Collision Repair to have the alignment corrected. Fulgencio was happy with the alignment on his truck after Expert Collision Repair worked on it. Sterling did not pay Expert Collision Repair for the repair as promised.

2. Allstate August 2002 Internal Review of Sterling Stores

94. In August 2002, Allstate conducted an internal review of the Sterling network of stores, and found (among other things), that the repair quality at Sterling was below PRO standards in 60% of its stores. In particular, Sterling's Houston stores were given failing marks.

95. Despite these findings, Allstate continued to refer its customers to Sterling.

L. Passage of H.B. 1131

96. Allstate and Sterling contend that H.B. 1131 was passed in order to shift autobody collision repair business from interstate companies such as Sterling to local body shops operating solely in Texas. To support this assertion, they rely on evidence that Intervenor ASA and various independent autobody shops pushed for the passage of H.B. 1131 before the Texas legislature. Allstate and Sterling have also presented facts showing that this effort flowed from the concerns of local independent shops that they would lose business to insurer-owned autobody shops.

97. If H.B. 1131 is upheld, and Sterling is unable to further expand its network of shops in Texas, collision repair work that may have been done by

Sterling will go to either locally-owned autobody repair shops or interstate collision repair chains (including interstate auto dealerships that operate collision repair facilities). Allstate and Sterling contend that because the number of interstate collision repair businesses that will continue to operate in Texas is relatively few (about 5), H.B. 1131 will have a "chilling effect" on interstate commerce.

98. Countering Allstate and Sterling's position that H.B. 1131 was passed for protectionist reasons, Defendants and Intervenors assert that H.B. 1131 is a regulation of the way insurance companies handle claims and provide services to their insureds.

99. Defendants and Intervenors have shown that Rep. Kino Flores, one of the bill's sponsors, was concerned that tied repair shops created a conflict of interest that would hurt consumers by eliminating their voice and their advocate (the independent repair facility) in the auto repair process, stating that:

> [b]y eliminating the only independent voice that the car owner has in the repair process, that of an independent body shop owner, insurance companies control both the money to pay for damage to a claimant's car and the person who will decide what repairs need to be made to get the car out of the door.
>
> Because publicly traded insurance companies have a responsibility to stockholders to seek the highest premium possible and pay the lowest claims for which they can negotiate, the consumer, caught in the middle of that equation, becomes irrelevant.

* * *

> What this bill seeks to do, Mr. Chairman and members of the committee, is to ensure that, number one, that the consumer has a choice.

100. On the House floor, Rep. Flores further explained: "we are trying to address an issue that deals strictly with conflict of interest."

101. Defendants and Intervenors have offered proof that other legislators also voiced similar concerns regarding conflicts of interest, worrying about the influence of insurance companies who are able to steer their policyholders toward tied repair shops.

102. Rep. Nixon explained:

> There's only one reason for them to have an auto shop is that it's for them to direct your banged-up vehicle to their shop so they can make an extra buck off you. That's it.

103. Rep. Puente concluded that:

> Essentially what we're trying to do with this bill is to look at conflicts of interest, make sure insurance companies that have control over body shops don't steer business towards them so they can earn a premium twice.

104. Senator John Carona, who offered H.B. 1131 in the Texas Senate, also explained that his chief motivation in supporting H.B. 1131 was to eliminate the obvious conflict of interest that arises when an insurance company also owns the repair facility.

105. The Texas House Committee on Licensing heard testimony about anticompetitive and anti-consumer conduct that was occurring as a direct result of insurers owning repair facilities. Witnesses testified that:

• Insurance companies "force repairers to use cheaper, more inferior parts, place caps on the prices that can be charged ... or steer business away from specific shops."

• They gave low estimates of what it cost to make repairs, making it more difficult to obtain competitive bids from shop Allstate did not control.

• Insurers forced the repair of vehicles under circumstances in which qualified repair shops concluded that the vehicle was a "structural total."

• Allstate directed repair facilities to perform only partial repairs or to cut corners when they could get away with it.

• Sterling did not engage in significant advertising but, instead, relied upon Allstate for referrals. Sterling employees even admitted they relied upon Allstate agents to guide customers to Sterling locations.

• Allstate terminated repair facilities from their PRO program that were near Sterling shops to increase the business available to Sterling.

• Mr. Shoemaker, owner of Toyota of Irving, testified that after Allstate opened a Sterling facility down the road from Toyota of Irving, that dealership became overwhelmed by the scrutiny and processing demands placed upon it by Allstate when it worked on Allstate vehicles. Toyota of Irving's Mr. Shoemaker testified: "they were out to drive us out of the market, and that was their intent for the shops up and down the street."

These concerns are also reflected in the bill analysis that was prepared by the House Research Organization on April 8, 2003, at the time H.B. 1131 was under consideration.

106. Allstate and Sterling exercised their rights before the Texas house, presented numerous witnesses, and attempted to persuade legislators that there is no harm arising from ownership of autobody repair facilities by insurance companies. Allstate's position before the legislature was that it wanted to curb fraud through its ownership of Sterling.

107. Although Allstate and Sterling contend there is no conflict of interest in an insurance company owning an autobody repair shop, consumer surveys that Allstate conducted prior to purchasing Sterling show that those consumers surveyed expressed the same concerns as the legislators did regarding conflicts of interest, cost-cutting, compromised quality and other issues. Consumers were concerned that Allstate would use its influence over Sterling to cut corners on auto repairs to save money and earn additional profits for Allstate. Indeed, while some consumers had no quarrel with such ownership, others consumers surveyed by Allstate stated:

- "There's too much probability of cost-cutting."
- "If Allstate owns the shops, are the workers working for me or for Allstate?"
- "I'm concerned about the quality of the staff and the work in a 'captive company.'"
- "Profitability might become too important."

- "It's a conflict of interest. They're saving money at my expense."
- "It's like an HMO. I don't want Allstate to have total control."
- Nearly half of the consumers involved in one of the surveys believed that Allstate should not own body shops because Allstate should be "sticking to insurance" and because of the potential for a "conflict of interest."

108. Further, the record shows that after H.B. 1131 was proposed, Allstate and Sterling had ample opportunity to resolve the legislators' concerns and convince them of the benefits offered by the Allstate/Sterling relationship. However, Allstate and Sterling failed to persuade the Texas legislature and H.B. 1131 was passed.

109. H.B. 1131 stopped Allstate and any other insurer from owning any autobody repair shops in Texas. It was passed on May 27, 2003 and was codified as Tex. Occ. Code § 2306.002(a), which states:

Sec. 2306.002. INSURER INTERESTS.

(a) Except as provided by this section, *an insurer may not own or acquire an interest in a repair facility.*

(Emphasis added).

110. H.B. 1131 took effect on September 1, 2003.

111. Under H.B. 1131, insurers are further barred from providing a "recommendation," "referral," or "access" to insurer-owned autobody shops "that is not provided on identical terms to other ... facilities." Tex. Occ. Code § 2306.006(4).

112. Insurers are also prohibited from "[a]uthoriz[ing] or allow[ing] a person representing the insurer ... to recommend ... that the policyholder ... obtain repairs at a tied repair facility, except to the extent that the person recommends other ... facilities." Insurers and autobody shops are prohibited from engaging in joint marketing, and insurers are banned from giving insurer-owned autobody shops preferential access to their names or logos. Tex. Occ. Code § 2306.006(3), (6), (9).

113. The statute provides an exception for facilities like Sterling that were already open for business or upon which construction had begun as of April 15, 2003, Tex. Occ. Code § 2306.002(b), although additional restrictions were also placed on those excepted insurer-owned facilities (referred to as "tied repair facilities") in sections 2306.004 through 2306.008 of the statute. These restrictions, and the effect they have had on the Allstate - Sterling relationship, are outlined in more detail below (*See* ¶ 120, *supra*).

114. Under H.B. 1131, only Sterling shops open for business or under construction as of April 15, 2003 could continue to do business in Texas. Thus, as enacted, H.B. 1131 restricts any additional insurer-owned shops from entering the Texas market.

115. H.B. 1131 limits the efficiencies Sterling could achieve through networked greenfield shops.

116. Because Sterling's operations in Texas are limited to the 15 shops it had opened prior to April 15, 2003, Sterling's costs of doing business in Texas are increased.

117. Sterling has also lost certain competitive advantages under H.B. 1131. Under Tex. Occ. Code §

2306.006(2), Allstate is barred from sharing information with Sterling that it does not make available to other repairers with which it has a favored facility agreement.

118. Additionally, section 2306.006(7) of the statute restricts Allstate from "subsidiz[ing] the business activities or operating expenses of a tied repair facility." Therefore, Allstate cannot subsidize Sterling's business through capital investments in Sterling's stores, requiring Sterling to absorb these costs and raising Sterling's cost of doing business in Texas. On average, Allstate has invested $2.6 million per store for improvements to existing Sterling stores or for building new "greenfield" stores.

119. H.B. 1131 also prevents Allstate from assisting in Sterling's efforts to generate business and increase its car volume, because Allstate may not recommend or refer its customers to Sterling in any way that is not provided identically to the repair shops in the PRO program. Tex. Occ. Code § 2306.006(4)-(5). Additionally, Allstate and Sterling may not engage in a joint marketing program and Sterling may not use Allstate's trademarks or logos in any way that the PRO shops are not also permitted to use them. Tex. Occ. Code § 2306.006(3), (6).

120. H.B. 1131's full list of prohibitions on insurers who own an interest in an auto repair facility (referred to as a "tied repair facility") is as follows. The prohibitions affecting the Allstate/Sterling relationship that are at issue in this case are italicized below:

Sec. 2306.006. PROHIBITIONS. An insurer may not:

(1) condition the provision of a product, service, insurance policy renewal, pricing, or other benefit on the purchase of any good or service from its tied repair facilities;

(2) *share information with its tied repair facilities that is not made available on identical terms and conditions to other repair facilities with which the insurer has entered into a favored facility agreement;*

(3) *engage in a joint marketing program with its tied repair facilities;*

(4) *provide its tied repair facilities a recommendation, referral, description, advantage, or access to its policyholders or other beneficiaries under its insurance policies that is not provided on* identical terms to other repair facilities with which the insurer has entered into a favored facility agreement;

(5) provide a tied repair facility access to the insurer's products or services on terms and conditions different from those under which the insurer provides access to the same products or services to another repair facility with which the insurer has entered into a favored facility agreement;

(6) allow a tied repair facility to use the insurer's name, trademark, tradename, brand, or logo in a manner different than that allowed for any other favored facility;

(7) subsidize the business activities or operating expenses of a tied repair facility;

(8) directly or indirectly require a policyholder of the insurer or other

beneficiary under the insurer's policy to obtain a damage estimate on a vehicle covered by the insurance policy at a tied repair facility;

(9) authorize or allow a person representing the insurer, whether an employee or an independent contractor, to recommend to a policyholder or other beneficiary under the insurance policy that the policyholder or other beneficiary obtain repairs at a tied repair facility, except to the same extent that the person recommends other repair facilities with whom the insurer has entered into a favored facility agreement;

(10) require a policyholder or beneficiary to use a claims center located on the premises of a tied repair facility;

(11) enter into a favored facility agreement exclusively with its tied repair facilities;

(12) retaliate or discriminate against a person who: (A) files an action as provided by this chapter; or (B) assists or participates in any manner in an investigation, judicial proceeding, or other action brought or maintained as provided by this chapter; or

(13) include earnings or losses of a tied repair facility in a rate filing made under Chapter 5, Insurance Code.

(Emphasis added).

M. Impact of H.B. 1131 on Allstate and Sterling

121. Since the enactment of H.B. 1131, Sterling has experienced a 50 percent drop in monthly volume,

closed three stores in Houston and relocated others. Sterling has also laid off some employees.

122. H.B. 1131 has also caused Allstate and Sterling to incur certain business redesign costs, including technology and other system changes. Because of H.B. 1131's requirement that Allstate treat Sterling the same as it treats other shops in its PRO program, Allstate also overhauled its PRO program in Texas and established a new program with more oversight dubbed ERO. As part of the overhaul, Allstate changed its inspection system by assigning each of its Damage Evaluators to fewer shops. In creating the ERO model, Allstate spent approximately $500,000 on staffing costs alone for the first 90 days of the program.

123. H.B. 1131's ban on expansion has also made it more difficult or impossible for Sterling to reduce costs through "load leveling," or shifting cars from one Sterling facility to another to increase the efficient utilization of capacity. Sterling is not able to take advantage of load leveling in certain markets like Austin, where it has only one store.

124. In the last four months of 2003, following the enactment of H.B. 1131, Sterling's Texas shops went from turning $2 million in profit to losing $2 million in earnings.

125. When Allstate acquired Sterling, Sterling lost its source of referrals from other auto insurers who dropped Sterling from their preferred provider programs.

126. Other insurers who continue to collectively hold 85% of the automobile insurance market in Texas will continue to rely upon non-Sterling independent autobody shops to repair their policyholders' cars.

127. Even though Allstate owns Sterling, its customers have the option of choosing another body shop, so Allstate cannot realistically expect all of its customers to use Sterling.

N. Allstate's Results with Sterling to Date, and Expert Opinions

128. The evidence shows that Allstate's acquisition of Sterling has produced mixed results to date, and has had problems achieving its goal of reducing costs in autobody repairs. Allstate attributes these inefficiencies to a number of factors including a) the immediate cessation of Sterling business from any other insurer after the date of the Allstate purchase; b) the passage of H.B. 1131, which chilled further expansion of its network of Sterling shops in Texas; and c) lower than anticipated volume from Allstate customers.

129. At trial, Allstate offered the testimony of its economist, Professor Scott Harrington. Professor Harrington discussed the "potential" efficiencies that could be achieved through the vertical integration of Allstate and Sterling. Professor Harrington did not testify before the Texas legislature prior to the passage of H.B. 1131. Professor Harrington believes that the Allstate/Sterling relationship was an "experiment" that should be allowed to go forward.

130. Professor Harrington's opinion that Allstate and Sterling should continue their relationship lies primarily in "possible" or "potential" economies to be realized by the two companies, including lower monitoring, quality assurance and administrative costs, improved capacity utilization (including "load leveling"), allocating particular employees to particular tasks, and the use of modern repair equipment. Regardless of Professor Harrington's

vision of the potential benefits of the Allstate/Sterling integration, the court finds that on the current factual record, Allstate has not yet realized the efficiencies he identifies. Further, the court notes that Allstate's Jeff Brask testified in July 2004 that Sterling's performance had been "disappointing" and that Sterling needed to improve its pricing (which had been 10-15 percent above PRO), gross margins and earnings.

131. Other evidence in this case shows that year after year of operations, the costs of repairs at Sterling tended to be higher than similar shops in the PRO network. Moreover, Allstate inspections of Sterling facilities showed repair quality lower than PRO standard in 60% of Sterling's stores. Knowing that these issues existed, Allstate nonetheless continued to refer its customers to Sterling.

132. The court finds the expert testimony of Dr. Donald House offered by Defendants and Intervenors to be credible. Dr. House has explained that there is no evidence to show that the vertical integration of insurance companies into the collision repair industry creates economies of scale. Dr. House believes, and the court agrees, that Allstate's ownership of Sterling gives Sterling economic incentives to under-repair vehicles, so that the costs paid by Allstate for repairs are reduced.

133. Despite these mixed results, Allstate claims to be committed to this project, because it believes the Sterling shops are the only way to achieve its goals of quality and lowered costs on a nationwide basis.

II. Conclusions of Law

1. Allstate and Sterling have challenged H.B. 1131 under the dormant Commerce Clause and First

Amendment of the United States Constitution. Prior to trial, the court entered a preliminary injunction against the enforcement of portions of H.B. 1131's code of conduct, specifically Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9), on First Amendment grounds. Allstate and Sterling have alternatively asserted that the trademark provisions of H.B. 1131 violate the Constitution's Supremacy Clause and are preempted by the Lanham Act, 15 U.S.C. § 1127.

2. Defendants and Intervenors maintain that H.B. 1131 is constitutional under both the dormant Commerce Clause and the First Amendment. They have further argued that Allstate and Sterling's constitutional challenges to H.B. 1131 are barred by the doctrine of constitutional estoppel, and that Allstate and Sterling's Commerce Clause claim is barred by the McCarran-Ferguson Act.

A. Commerce Clause Challenge

1. McCarran-Ferguson Act

3. Defendants and Intervenors contend that Allstate and Sterling's Commerce Clause attack on H.B. 1131 is barred by the McCarran-Ferguson Act. In the McCarran-Ferguson Act, Congress granted the several states the primary authority to enact legislation that relates to the regulation or taxation of the business of insurance. See 15 U.S.C. §§ 1011, 1012(a). In doing so, Congress insulated state regulations relating to the "business of insurance" from any challenge under the Commerce Clause (dormant or exercised) of the *United States Constitution*. *American Ins. Ass'n v. Garamendi*, 539 U.S. 396, 428 (2003); *Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 653 (1981); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429-30 (1946).

4. Section 2(a) of the McCarran-Ferguson Act provides as follows:

> The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.

15 U.S.C. § 1012(a). The Supreme Court has stated that the principal focus of the regulatory authority reserved to the states by McCarran-Ferguson was "the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the 'business of insurance.'" *SEC v. National Securities, Inc.*, 393 U.S. 453, 460 (1969). However, the McCarran-Ferguson Act does not "purport to make the states supreme in regulating all the activities of insurance companies ... only when they are engaged in the 'business of insurance' does the statute apply." *U.S. Life Corp. v. U.S. Life Ins. Co.*, 560 F. Supp. 1302, 1306-07 (N.D. Tex. 1983), quoting *National Securities*, 393 U.S. at 459-60. Accordingly, the court must determine whether H.B. 1131 regulates "the business of insurance" as intended by the McCarran-Ferguson Act.

5. The court must consider three factors in evaluating whether H.B. 1131 regulates "the business of insurance": 1) whether the practice in question has the effect of transferring or spreading a policyholder's risk; 2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and 3) whether the practice is limited to entities within the insurance industry. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982); *American Bankers Ins. Co. of Florida v.*

Inman, 436 F.3d 490, 493 (5th Cir. 2006); *Munich American Reinsurance Co. v. Crawford*,141 F.3d 585, 590- 91 (5th Cir.), *cert. denied*, 525 U.S. 1016 (1998). None of the three factors is determinative, but examination of the factors may lead to a determination whether a state law regulates "the business of insurance." *Pireno*, 458 U.S. at 129.

a. Transfer or Spread of Policyholder Risk

6. *In Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205, 209 (1979), an insurance company ("Blue Shield") entered into agreements with certain "participating pharmacies" who capped the price of prescription drugs paid by Blue Shield. A group of independent non-participating pharmacies sued Blue Shield under the Sherman Act, 15 U.S.C. § 1. *Id.* at 207. Blue Shield argued that the participating pharmacy agreements were "the business of insurance" and thus were exempt from the antitrust laws under the McCarran-Ferguson Act. *Id.*

7. The Supreme Court considered whether the pharmacy agreements involved any underwriting or spreading of risk, and held that the agreements did not. *Id.* at 214. The Court stated that the agreements enabled Blue Shield to minimize costs and maximize profits, holding that "[s]uch cost-savings arrangements may well be sound business practice, and may well inure ultimately to the benefit of policyholders in the form of lower premiums, but they are not the 'business of insurance.'" *Id.* The Court described the pharmacy agreements as "legally indistinguishable" from "countless" business arrangements that insurance companies may make to reduce costs. *Id.* at 215.

Notably, the Court further observed that if Blue Shield had decided to acquire a drug store chain in order to further lower its costs of meeting its obligations to its policyholders, such an acquisition would not be "the business of insurance" as contemplated by the McCarran-Ferguson Act. *Id.*, *citing National Securities*, 393 U.S. 453.

8. Here, Allstate's ownership of Sterling does not transfer or spread a policyholder's risk. The evidence in this case shows that Allstate acquired Sterling with the intent of lowering its costs to repair cars and therefore increasing its profits. Although it is possible that any cost savings achieved by Allstate through its ownership of Sterling could result in lower premiums for Allstate's customers, this factor does not favor a finding that Allstate's ownership of Sterling is "the business of insurance" as required by the McCarran-Ferguson Act. *Pireno*, 458 U.S. at 128, *citing Royal Drug*, 440 U.S. at 214.

b. Effect of the Practice on the Insurer-Insured Relationship

9. Next, the court must examine whether Allstate's ownership of Sterling is a practice integral to its relationship with its policyholders. *Pireno*, 458 U.S. at 129. The Supreme Court has noted that in enacting the McCarran-Ferguson Act, Congress was concerned with "'the relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement - these were the core of the "business of insurance."'" *Id.* at 128, *quoting National Securities*, 393 U.S. at 460.

10. In *Royal Drug*, Blue Shield argued that its pharmacy agreements were closely related to its policy relationship with its insureds, an argument

the Supreme Court rejected. The Court noted that the pharmacy agreements were not agreements between Blue Shield and its insureds, but were separate contractual arrangements for the provision of goods and services other than insurance. 440 U.S. at 216. Further, the Court observed that at most, the pharmacy agreements resulted in cost savings that might be passed on to customers in the form of lowered premiums. *Id.* at 216.

11. However, the Court stated that even if this tangential relationship to customers is found, it does not confirm that the practice at issue constitutes "the business of insurance." *Id.* at 216. The Court recognized that in that sense, every business decision made by an insurance company has some impact on its reliability, its ratemaking, and its status as a reliable insurer, and if the insurer - insured relationship is construed broadly, almost every business decision of an insurance company could be included in "the business of insurance." *Id.* at 216-17. "Such a result would be plainly contrary to the statutory language, which exempts the 'business of insurance' and not the 'business of insurance companies.'" *Id.* at 217.

12. Here, Allstate's ownership of Sterling involves the sale of collision repair services - a business separate and apart from the sale of insurance policies. It is undisputed that although Allstate would prefer that its customers use Sterling to repair their vehicles, Allstate does not require its insurance customers to use Sterling for their collision repairs as a part of the insurer-insured relationship. Despite the fact that H.B. 1131 was passed in large part due to concerns raised about the conflict of interest arising in the repair of vehicles by

shops owned by the policyholder's insurance company, the "take it or leave it" nature of the Sterling repair option does not make Allstate's ownership of Sterling integral to the insurer-insured relationship.

13. The record further shows that Allstate decided to enter the collision repair industry in order to reduce its collision repair costs and increase its profits. Although this practice by Allstate could conceivably lead to reduced premiums for its car insurance customers, under the *Royal Drug* and *Pireno* decisions this fact does not show that by owning Sterling, Allstate is engaged in "the business of insurance" under the McCarran-Ferguson Act. *Pireno,* 458 U.S. at 128; *Royal Drug,* 440 U.S. at 216-17.

14. Moreover, H.B. 1131 explicitly concerns matters of a much broader scope than the relationship between auto insurance companies and their policyholders. Under H.B. 1131, insurance companies are restricted as to subsidiaries they cannot own and what lines of business they cannot go into other than insurance – how they run their businesses beyond the confines of the insurance contract with their customers. This factor also does not support a finding that Allstate is in the "business of insurance" by owning Sterling.

15. For all of these reasons, the court finds that Allstate's ownership of Sterling is not an "integral part" of its relationship with its policyholders.

c. Whether the Practice is Limited to Entities Within the Insurance Industry

16. Finally, under the third *Royal Drug/Pireno* criterion, the court must consider whether the disputed practice is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 129; *Royal Drug*, 440 U.S. at 231. In enacting the McCarran-Ferguson Act, Congress was concerned that the cooperative ratemaking efforts of insurance companies be exempt from the antitrust laws, because it is "difficult to underwrite risks in an informed and responsible way without intra-industry cooperation." *Pireno*, 458 U.S. at 129, *quoting Royal Drug*, 440 U.S. at 221. In situations involving the purchase or sale of goods and services from entities outside the insurance industry, the legislative history of the McCarran Ferguson Act does not support a finding that such arrangements are "the business of insurance." *Id.* at 129.

17. In this case, Allstate has entered into a business outside the insurance industry. Although the insurance industry is a customer of the collision repair industry, the collision repair industry is outside the insurance industry, much like the pharmacies in *Royal Drug*. Even the fact that Sterling receives the majority of its business through referrals from Allstate does not mean that Allstate's ownership of Sterling is the "business of insurance." "The attempted use of an established insurance market to secure an additional market in some non-insurance product or service is not, by itself, a part of the business of insurance." *Zelson v. Phoenix Mutual Life Ins. Co.*, 549 F.2d 62, 68 (8th Cir. 1977). Thus, this factor also does not show that Allstate's

ownership of Sterling is "the business of insurance" as contemplated by the McCarran-Ferguson Act. The court therefore holds that the McCarran-Ferguson Act does not exempt H.B. 1131 from Allstate and Sterling's dormant Commerce Clause challenge.

2. Dormant Commerce Clause

18. Allstate and Sterling's principal attack on H.B. 1131 arises under the dormant Commerce Clause. This aspect of the Commerce Clause is known as the dormant or "negative" aspect of that clause, because the United States Supreme Court has interpreted it to prohibit economic protectionism. *West Lynn Creamery v. Healy,* 512 U.S. 186, 193 n.9 (1994). They assert that H.B. 1131 is unconstitutional because it discriminates against interstate commerce, and that even if the statute is facially valid, the burden imposed by H.B. 1131 on interstate commerce clearly exceeds any local benefits it provides.

a. Applicable Law

19. The Commerce Clause of the United States Constitution provides that "[t]he Congress shall have Power ... [t]o regulate Commerce ... among the several States." Art. I, § 8, cl. 3. Thus, the Constitution specifically grants to Congress the power to regulate interstate commerce. *Ford Motor Co. v. Texas Dept. of Transportation,* 264 F.3d 493, 499 (5th Cir. 2001). Where a state law conflicts with a federal law governing commerce, the Supremacy Clause mandates that the state law be invalidated. *Id.* In matters not governed by federal legislation, "the Clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." *Id., quoting*

Oregon Waste Systems, Inc. v. Department of Environmental Quality, 511 U.S. 93, 98 (1994).

20. The dormant Commerce Clause prohibits states from engaging in economic protectionism through discrimination against interstate commerce. *Intl. Truck and Engine Corp. v. Bray*, 372 F.3d 717, 724-25 (5th Cir. 2004); *Dickerson v. Bailey*, 336 F.3d 388, 395 (5th Cir. 2003). Although the dormant commerce clause protects the interstate market, it does not exist to protect individual interstate companies or a "particular structure or methods of operation ... in a market." *Intl. Truck*, 372 F.2d at 727, *citing Exxon Corp. v. Maryland*, 437 U.S. 117, 127-28 (1978) and *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 93-94 (1987).

b. Constitutional Tests for Dormant Commerce Clause Challenges

21. A dormant Commerce Clause analysis begins with the question whether the statute at issue either 1) facially, 2) purposefully, or 3) effectually discriminates against interstate commerce or out-of-state interests, or whether the statute regulates evenhandedly with only incidental effects on interstate commerce. *Intl. Truck*, 372 F.3d at 725, *citing Ford*, 264 F.3d at 499; *Lenscrafters v. Robinson*, 403 F.3d 798, 802 (6th Cir. 2005). If the statute is found to discriminate, then it is valid only if the state "can demonstrate, under a rigorous scrutiny test, that it has no other means to advance a legitimate local interest." *C & A Carbone, Inc. v. Town of Clarkstown, N.Y.*, 511 U.S. 383, 392 (1994), *cited in Intl. Truck*, 372 F.3d at 725. If the statute does not discriminate, then the statute is valid under the *Pike* test unless the burden imposed on interstate commerce is "clearly excessive" in relation

to the putative local benefits. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *Intl. Truck*, 372 F.3d at 725; *Lenscrafters*, 403 F.3d at 802.

22. In the Commerce Clause context, the term "discrimination" means "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Intl. Truck*, 372 F.3d at 725, *quoting Or. Waste Sys., Inc. v. Dept. of Environmental Quality*, 511 U.S. 93, 99 (1994). Discrimination may be found based on evidence of either discriminatory effect or discriminatory purpose. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984). However, discrimination does not include all instances in which a state law burdens an out-of-state interest while benefiting some in-state interest. *Intl. Truck*, 372 F.3d at 725; *Ford*, 264 F.3d at 500.

23. "The mere fact that a statute has the effect of benefitting a local industry while burdening a separate interstate industry does not in itself establish that the statute is discriminatory." *Tex. Manufactured Hous. Assn. v. City of Nederland*, 101 F.3d 1095, 1102 (5th Cir. 1996). A state statute discriminates "only when a state discriminates among similarly situated in-state and out-of-state interests." *Ford*, 264 F.3d at 500. That the challenged law affects only out-of-state interests does not tend to prove discrimination, unless it discriminates between similarly situated in-state and out-of-state interests. *Exxon*, 437 U.S. at 125-26; *Intl. Truck*, 372 F.3d at 725 n.9 (citations omitted).

c. Dormant Commerce Clause Analysis

24. Allstate and Sterling bear the burden of proof to show that H.B. 1131 violates the dormant commerce clause. *Lenscrafters*, 403 F.3d at 803; *USA Recycling*,

Inc. v. Town of Babylon, 66 F.3d 1272, 1281 (2d Cir. 1995), *citing Hughes v. Oklahoma,* 441 U.S. 322, 336 (1979). The threshold question under the dormant Commerce Clause is whether the challenged statute is discriminatory. *Intl. Truck,* 372 F.3d at 725; *Lenscrafters,* 403 F.3d at 802. A statute can discriminate in three ways: 1) on its face; 2) purposefully; or 3) in practical effect. *Wyoming v. Oklahoma,* 502 U.S. 437, 454-55 (1992); *Lenscrafters,* 403 F.3d at 802.

i. Facial Discrimination

25. The statutory text of Tex. Occ. Code 2306.002 refers to and restricts the ownership in an auto repair facility by "an insurer." On its face, the statute makes no distinction between in-state and out-of-state insurers owning auto repair facilities, so there is no facial discrimination present. To resolve the dormant Commerce Clause question, the court must look to the other two ways to discriminate and examine whether H.B. 1131 has either a discriminatory purpose or effect.

ii. Discriminatory Purpose

26. "When a party seeks to present circumstantial evidence of a discriminatory purpose pursuant to a dormant Commerce Clause challenge, it is the duty of that party to show the effect of that evidence on the challenged statute." *Lenscrafters,* 403 F.3d at 803, *quoting E. Ky. Res. v. Fiscal Court of Magoffin County, Ky.,* 127 F.3d 532, 542-43 (6th Cir. 1997). Allstate and Sterling contend that H.B. 1131 was created in order to discriminate against out-of-state insurance companies. In support of their position, they rely on 1) statements made by legislators who sponsored, voted for, or drafted the legislation; 2) that local competitors, rather than consumers,

sought the legislation; and 3) irregularities in the drafting process. Allstate and Sterling do not offer any evidence of irregularities in the drafting process, so the court will not address this issue.

27. The court agrees that the record contains numerous references to statements by various local competitors of Sterling expressing their concerns that insurer-owned collision repair chains like Sterling would divert business from the independently-owned body shops in Allstate's PRO program. The record further shows that the drafting and enactment of H.B. 1131 was largely spurred by a coalition of the small business owners who compete with larger autobody repair chains like Sterling. Evidence was also offered from new car dealers that backed H.B. 1131.

28. Regardless of this evidence, the court has also found the trial record replete with proof that the members of the Texas legislature were concerned with the lack of independence and conflicts of interest that arise when a consumer repairs his or her vehicle at an autobody shop owned by his or her insurance company. Witnesses testified to support these concerns, such as insurance companies cutting costs on repairs, approving only partial repairs, requiring that cars be repaired instead of "totaled," trying to steer customers to insurer-owned shops, and Allstate terminating PRO shops in order to increase business for Sterling.

29. Based upon this evidence, the court cannot find that the purpose of the bill was to discriminate *between in-state and out-of-state businesses*, a finding that must anchor a successful Commerce Clause challenge. *See Ford*, 264 F.3d at 500 (to be constitutionally impermissible, statute must

discriminate between similarly situated instate and out-of-state interests). The evidence offered by Allstate and Sterling to show purposeful interstate discrimination tends to show that the purpose of H.B. 1131 was to discriminate between two differing business models – independently-owned autobody repair shops (which include "Mom and Pop" shops, multistate collision repair chains, and new car dealers) versus autobody repair shops owned by automobile insurance companies.

30. The evidence further suggests that the purpose of H.B. 1131 was to apply its prohibitions evenhandedly, to both in-state and out-of-state automobile insurers. The concerns raised about insurance companies owning autobody repair facilities apply regardless of whether those shops are owned by in-state or out-of-state automobile insurers. *See Lenscrafters*, 403 F.3d at 803 (purpose was non-discriminatory where legislation's proponents were concerned with optometrists practicing in conjunction with retail eyewear providers, whether or not those retailers were owned by in-state or out-of-state interests).

31. While the facts do support a finding that H.B. 1131's purpose was to protect one business model over another by favoring independent autobody shops over those owned by insurers, this purpose does not affect the dormant Commerce Clause.

It is well established that the Commerce Clause does not protect a particular business structure or method of operation in a market, but only protects interstate commerce from prohibitive or burdensome regulations. *CTS Corp.*, 481 U.S. at 93-94; *Exxon*, 437 U.S. at 127; *Intl. Truck*, 372 F.3d at 727. Accordingly, Allstate and Sterling have not shown

that H.B. 1131 has a discriminatory purpose violative of the Commerce Clause.

iii. Discriminatory Effect

32. The final possible way a statute can discriminate in the practical effect the statute has on the interstate commerce of the industry involved. Allstate and Sterling contend that in addition to a discriminatory purpose, H.B. 1131 has a discriminatory effect on interstate commerce. The court disagrees.

33. Allstate and Sterling's primary argument regarding practical effect is that Sterling is currently the only insurer-owned autobody repair chain operating in Texas. They maintain that H.B. 1131 discriminates against interstate commerce in its practical effect by disproportionately impacting them as out-of-state companies. In prior decisions, both the Fifth Circuit and the United States Supreme Court have rejected this argument. *Intl. Truck,* 372 F.3d at 726, *citing Exxon,* 437 U.S. at 126; *Ford,* 264 F.3d at 502; *see also Lenscrafters,* 403 F.3d at 805. "That all or most affected businesses are located out-of-state does not tend to prove that a statute is discriminatory." *Intl. Truck,* 372 F.3d at 726.

34. The burden of H.B. 1131 affects in-state and out-of-state automobile insurance companies equally, in that the statute permits no automobile insurer, regardless of whether they are domiciled in Texas or elsewhere, to own and operate autobody repair facilities. If the statute causes any shifting of business from insurer-owned to independent repair shops, the burden of that shift will fall on *all* insurer-owned facilities, not just those owned by out-of-state entities. H.B. 1131 does not prohibit nor adversely affect non-insurer owned interstate

collision repair chains from operating in Texas. The chains of interstate collision repair shops that operate in Texas may operate outside the effects of H.B. 1131. In addition, those chains may be owned by any entity except an automobile insurance company.

35. If there is any shift in business from Sterling to other autobody repairers, some of that business should shift toward these other interstate companies. H.B. 1131's regulatory burden falls equally on both in-state and out-of-state automobile insurance companies, and is not discriminatory. *See Intl. Truck*, 372 F.3d at 727 (where the burden of the statute could fall on both in-state and out-of-state manufacturers, statute is nondiscriminatory); *Ford*, 264 F.3d at 502 (statute that only prevented manufacturers, regardless of their domicile, from entering the retail market protected dealers from manufacturers, not out-of-state competition); *Lenscrafters*, 403 F.3d at 805 (law prohibiting all optical retailers from leasing space to optometrists did not discriminate among in-state and out-of-state companies wishing to sell eyewear).

36. Citing *Exxon*, Allstate and Sterling assert that when an interstate firm loses more business due to a state regulation than in-state firms do, and that loss of business is not "promptly replaced" by other interstate firms, the regulation violates the dormant Commerce Clause. *See Exxon*, 417 U.S. at 127. Allstate and Sterling refer to this alleged standard as *Exxon's* "business shifting test." In the court's view, Allstate and Sterling have read the phrase "promptly replaced" somewhat out of context.

37. In *Exxon*, the regulation at issue prohibited oil refiners from owning and operating retail gas

stations within the State of Maryland. 437 U.S. at 119. There, like here, the refiners argued that the effect of the statute was to protect independent dealers from out-of-state competition, and pointed out that in actuality, the entire burden of the law would fall on out-of-state companies. *Id.* at 125. The Supreme Court rejected the notion that a burden falling singularly on out-of-state companies necessarily shows discrimination against interstate commerce, stating that "this fact does not lead, either logically or as a practical matter, to a conclusion that the State is discriminating against interstate commerce at the retail level." *Id.*

38. The Court noted that the act at issue raised no barriers whatsoever to interstate independent dealers who were not also refiners of petroleum products. *Id.* at 126. It further stated that the act "creates no barriers whatsoever against interstate independent dealers; it does not prohibit the flow of interstate goods, place added costs upon them, or distinguish between in-state and out-of-state companies in the retail market." *Id.* It concluded that "[t]he absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce." *Id.*

39. Despite the absence of discrimination, the refiners in *Exxon* argued that the act burdened interstate commerce because certain refiners would stop selling in Maryland, depriving consumers of "special services" provided by the company-owned retail gas stations. *Id.* at 127. The Court determined that even if both of these facts were presumed true, "neither warrants a finding that the statute burdens interstate commerce." *Id.*

40. In rejecting this argument, the Court further noted that even if some refiners completely withdrew from the Maryland market, it expected that those refiners' share of the entire supply would be "promptly replaced" by other interstate refiners. *Id.* Significantly, the Court noted in *Exxon* that no petroleum products were actually produced or refined in Maryland. *Id.* at 123. Accordingly, the Court's observation that any gaps left in the wholesale petroleum market would be filled by another interstate supplier is not a particularly significant part of the analysis, since in that case the only source of supply at the wholesale level was the interstate market. Therefore, the court disagrees with Allstate and Sterling that this language is a "business shifting test" to be strictly applied in determining whether a statute has a discriminatory effect on interstate commerce.

41. More importantly, when the "promptly replaced" language is read in context, it is clear that the Court did not articulate a requirement that any shift of business away from an interstate supplier must only go to another interstate supplier to be constitutional under the Commerce Clause. Instead, the plain language of the opinion merely rejects the refiners' contention that interstate commerce was impermissibly burdened by the shifting of business from certain interstate suppliers to other interstate suppliers. *Id.* at 127. Therefore, this court declines to read into *Exxon* a per se rule that any "business shifting" flowing from a state regulation must only occur between interstate entities to avoid an unconstitutional discriminatory effect on interstate commerce. *See Exxon*, 437 U.S. at 125-27.

42. "If the effect of a state regulation is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share" of the market, "the regulation *may* have a discriminatory effect on interstate commerce." *Id.* at 126 n.16 (emphasis added). If Sterling were to leave the Texas market, it is impossible to predict precisely where its current share of the market would be reallocated. However, since the market is currently composed of both intrastate and interstate firms, it is reasonable to expect that some of Sterling's business would go to intrastate repair shops, and some would go to interstate repair shops. Allstate and Sterling have not shown otherwise – *i.e.*, that the statute will necessarily cause a discriminatory shift in business to intrastate entities.

43. Restrictions on vertical integration have been consistently upheld in analogous cases. *See Exxon*, 437 U.S. 117 (finding that the statute was not discriminatory against plaintiff because its treatment by the law was based on its status as an oil refiner and not on its contacts with Maryland); *Intl. Truck*, 372 F.3d at 726 (finding that the law was not discriminatory for commerce clause purposes since it was not discriminatory against plaintiff because of its state of origin); *Ford*, 264 F.3d at 502 (finding that, for commerce clause purposes, the statute was not discriminatory against plaintiff because its treatment by the law was based on its status as a manufacturer and not on its contacts with Texas); *Ford Motor Co. v. Ins. Comm'r*, 874 F.2d 926, 942-43 (3d Cir. 1989) (finding that, for commerce clause purposes, the statute was not discriminatory against plaintiff because its

treatment by the law was based on its status as an insurer and not on its contacts with Pennsylvania).

44. The court finds that the present challenge to H.B. 1131 is analytically indistinguishable from the challenges rejected by the courts in *Exxon*, the *Ford* cases, and *Intl. Truck*. Because the statute does not discriminate 1) facially, 2) purposefully, or 3) effectually, the court concludes that H.B. 1131 does not discriminate against interstate commerce.

iv. *Pike* Balancing Test

45. Because the court has determined that H.B. 1131 is not discriminatory, the well-known *Pike* balancing test must be applied. *Intl. Truck*, 372 F.3d at 727; *Ford*, 264 F.3d at 503. Under the *Pike* test the statute is valid unless Allstate and Sterling show by a preponderance of the evidence that the burden imposed on interstate commerce is "clearly excessive" in relation to the statute's putative local benefits. 397 U.S. at 142; *Intl. Truck*, 372 F.3d at 727.

46. A statute burdens interstate commerce when it inhibits the flow of goods interstate. *Intl. Truck*, 372 F.3d at 727; *Ford*, 264 F.3d at 503. Allstate and Sterling have not demonstrated that H.B. 1131 inhibits the flow of collision repair services from out-of-state providers into Texas. It is undisputed that the law does not prohibit interstate collision repair chains from operating in or entering the Texas market, and evidence was presented at trial to show that interstate firms such as the Boyd Group, CarStar, VT, Inc., Automotive Investment Group, Sonic, Group One, AutoNation, and all interstate new car dealers that have repair shops have been operating and continue to operate here. Allstate and Sterling's entire argument regarding the supposed

burden H.B. 1131 places upon interstate commerce actually revolves around the burden that H.B. 1131 places upon only *Allstate, Sterling, and other insurer-owned repair shops.* While this burden on Allstate and Sterling is obvious, the dormant Commerce Clause protects the interstate *market,* not particular interstate firms. *Exxon,* 437 U.S. at 127-28 (emphasis added).

47. To support their argument, Allstate and Sterling urge the court to rely upon *Lewis v. BT Investment Managers, Inc.,* 447 U.S. 27 (1980), a case in which the United States Supreme Court determined that a Florida regulation prohibiting out-of-state companies from owning or controlling a business within the state that furnished investment advisory services directly burdened interstate commerce and violated the dormant Commerce Clause. However, in *Lewis* the plain language of the statute prohibited out-of-state-owned banks, but not Florida-owned banks, from owning banks or trust companies that furnished investment advisory services within the state. 447 U.S. at 32 n.2.

48. The Court found the non-evenhanded nature of the state statute "highly significant" for purposes of its Commerce Clause analysis. *Id.* at 42. The Court further emphasized that the Florida statute discriminated "*among* affected business entities according to the extent of their contacts with the local economy." *Id.* (Emphasis in original). Thus, this key factor "significantly alter[ed]" the law's Commerce Clause status. *Id.* For this reason, the Court determined that despite some legitimate local concerns, the disproportionate burden the statute placed on out-of-state bank holding companies could not be justified by those concerns, and ruled that the

statute did burden interstate commerce in a way that "contravene[d] the Commerce Clause's implicit limitation on state power." *Id.* at 42-44.

49. Here, the court has already determined that H.B. 1131 regulates evenhandedly, placing the same prohibitions on insurer ownership of collision repair shops on all automobile insurance companies, regardless of their domicile within or without Texas. Therefore, H.B. 1131 is dissimilar to the statute at issue in *Lewis* because H.B. 1131 treats all similarly situated business entities the same.

50. By contrast, the Court in *Lewis* held that the statute at issue there was "*not* evenhanded" because it prohibited only "banks, bank holding companies, and trust companies with principal operations *outside* Florida" from operating investment subsidiaries or giving investment advice within the State." *Id.* at 42 (emphasis in original). There, the Court held that the statute at issue did discriminate "*among* affected business entities according to the extent of their contacts with the local economy." *Id.* The Court further cited *Exxon*, and noted that "the absence of a similar discrimination between interstate and local producer-refiners was a *most critical* factor" in its decision that the statute at issue there did not discriminate. *Id.* (emphasis added).

51. For this same reason, the court views this case as much more apposite to *Exxon*, and does not consider *Lewis* controlling or persuasive on the facts presented here. Unlike the facts in *Lewis*, Allstate and Sterling have not shown that H.B. 1131 burdens interstate commerce by inhibiting the overall flow of collision repair services into Texas, rather than just the negative effects on themselves and any other

insurance company-owned shops. H.B. 1131 does not discriminate or adversely impact the interstate market; it merely limits the manner in which insurers may participate in the autobody repair industry.

52. For example, if H.B. 1131 provided that only Texas-based insurance companies could vertically integrate with autobody repair facilities then this would bring H.B. 1131 under *Lewis*. However, the record is clear that H.B. 1131 does not differentiate between similarly situated in-state and out-of-state interests. Under H.B. 1131, Texas-based USAA and Texas county mutuals, including Allstate County Mutual, are treated the same as Allstate or any other out-of-state insurance company doing business in Texas.

53. Finally, even if the absence of Allstate and Sterling's autobody repair services from the Texas market did impose a minimal burden on interstate commerce, that burden would not be excessive in light of the statute's putative local benefits. In assessing H.B. 1131's putative local benefits, the court cannot "second guess the empirical judgments of lawmakers concerning the utility of the legislation." *Intl. Truck*, 372 F.3d at 728, *quoting CTS*, 481 U.S. at 92. The court must credit a putative local benefit "so long as an examination of the evidence before or available to the lawmaker indicates that the regulation is not wholly irrational in light of its purposes." *Ford*, 264 F.3d at 504, *quoting Kassell v. Consolidated Freightways Corp.*, 450 U.S. 662, 680-81 (1981); *see also Intl. Truck*, 372 F.3d at 728 (same).

54. The record shows that when the Texas legislators considered H.B. 1131, they considered concerns of

the possible conflicts of interest and lack of independence of the body shops that could arise if automobile insurers were permitted to own body shops. They further heard from witnesses who provided information regarding anticompetitive and anti-consumer conduct by insurance companies (including Allstate), such as forcing repairers to use cheaper parts, giving low estimates that made it difficult to obtain competitive bids from shops not controlled by Allstate, directing repair facilities to perform only partial repairs, and terminating PRO shops located near Sterling shops to increase business for Sterling. The record shows that various Texas legislators supported H.B. 1131 in order to preclude a conflict of interest between automobile insurers and their insureds and customers.

55. The Fifth Circuit has held that the prevention of vertical integration to stop vertically integrated companies from taking advantage of their market position, and preventing frauds, unfair practices, discrimination, impositions and other abuses of its citizens are legitimate state interests. *Ford,* 264 F.3d at 503. In this case, based upon the facts presented to the Texas legislature, a reasonable legislator could rationally have believed that H.B. 1131 would further the state's legitimate interests in the prevention of unfair competition and consumer protection. Therefore, the court must find that H.B. 1131 advances these putative local benefits. *Ford,* 264 F.3d at 504; *Intl. Truck,* 372 F.3d at 728.

56. When H.B. 1131 was under consideration, evidence supporting its stated concerns as to conflict of interest, lack of independence, loss of a "voice" for the consumer in the repair process, and anti-competitive and anti-consumer conduct taken by

Allstate and other insurance carriers were all before the legislators. The court cannot find that the passage of H.B. 1131 by the Texas legislature was "wholly irrational in light of its purposes." H.B. 1131 thus survives the *Pike* balancing test, and the court holds that it does not violate the dormant Commerce Clause.

B. First Amendment Claims

57. Allstate and Sterling challenge four specific restrictions found in section 2306.006 of the statute on the grounds that such restrictions are unconstitutional in that they unlawfully restrict Plaintiffs' First Amendment freedom of speech. *See* Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9).

58. The First Amendment, as applied to the states through the Fourteenth Amendment, protects commercial speech from unwarranted governmental regulation. *Central Hudson Gas & Electric Corp. v. Public Svc. Comm. of New York,* 447 U.S. 557, 561 (1980); *Virginia Pharmacy Bd. v. Virginia Citizens Consumer Council,* 425 U.S. 748, 761-62 (1976). "Commercial expression not only serves the economic interest of the speaker, but also assists consumers and furthers the societal interest in the fullest possible dissemination of information." *Central Hudson,* 447 U.S. at 561-62.

59. Specifically, Plaintiffs challenge on First Amendment grounds the statute's prohibitions on:

- engaging in a joint marketing program with a tied repair facility;
- providing tied repair facilities a recommendation, referral or description not provided on identical terms to other

preferred repair facilities (here, PRO program shops);

- allowing a tied repair facility to use its name in a manner different from that allowed for any PRO shops; and
- recommending that policyholders have their vehicles repaired at a tied repair facility, except to the same extent it recommends PRO repair facilities. Tex. Occ. Code §§ 2306.006 (3), (4), (6) and (9).

60. The Supreme Court has stated that speech proposing a commercial transaction is entitled to the protections of the First Amendment. *44 Liquormart, Inc. v. Rhode Island,* 517 U.S. 484, 502 (1996). Plaintiffs argue that under the First Amendment analysis laid out by the Supreme Court in *Central Hudson,* 447 U.S. at 566, the restrictions imposed by subsections 2306.006 (3), (4), (6) and (9) of the statute are unconstitutional because they violate their First Amendment right to free commercial speech.

61. Defendants and Intervenors argue that the challenged statutory provisions compel rather than restrict speech, and thus they urge the court to apply the more deferential standard articulated in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio,* 471 U.S. 626, 651 (1985), which provides that a statute compelling commercial speech must be upheld if it is reasonably related to the state's interest and is not unduly burdensome. *Id.* The court finds, however, that *Zauderer* is distinguishable from the speech at issue in this case.

62. In *Zauderer,* an attorney placed an advertisement seeking clients who had been injured

by using a contraceptive known as the Dalkon Shield Intrauterine Device, stating that such cases would be handled by his firm on a contingent fee basis and that "[i]f there is no recovery, no legal fees are owed by our clients." 471 U.S. at 630. He was then disciplined by the state bar for failing to disclose in the advertisement that if a client's lawsuit was unsuccessful, the client could still be responsible for litigation costs and expenses. *Id.* at 633.

63. The court held that because the extension of First Amendment protection

to commercial speech was principally justified by the value to consumers of the information such speech provides, the attorney's constitutionally-protected interest in not providing this factual information was minimal. *Id.* at 651, *citing Virginia Pharmacy Bd.*, 425 U.S. 748. The attorney urged the Court to apply a "least restrictive means" analysis to the disclosure requirement. *Id.* at 651 n.14. Under a "least restrictive means" standard, a statute should be struck down if there are other "less restrictive" means by which the state's purposes may be served. *Id.* The Court refused, noting that while it had applied such analysis to an outright prohibition on speech, compelled disclosures implicated a "substantially weaker" First Amendment interest, and thus the level of scrutiny articulated in *Central Hudson* and other cases involving actual suppression of speech was too high. *Id., citing Central Hudson,* 447 U.S. at 565.

64. In the instant case, Defendants and Intervenors have never cited to anything in Allstate's script that is false or misleading, and the court has found that the

content of Allstate's script is not false or misleading. Allstate's script tells its customers directly that they may choose any autobody repairer they wish. Although Allstate encourages its policyholders to use Sterling, it also discloses its affiliation with Sterling, allowing the customer to determine whether they are comfortable with using a repair facility with a corporate connection to their insurance company.

65. Rather, Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) restrict Plaintiffs from speaking about Sterling at all, unless PRO shops are also mentioned on the same terms as Sterling.

66. These restrictions on Plaintiffs' speech regarding Sterling do not prevent or correct any potential misapprehension or deception as was the case in *Zauderer*. Furthermore, H.B. 1131 does not force Allstate to disclose its relationship with Sterling, because Allstate already makes that disclosure.

67. The court holds that this is not a "compelled speech" case within the purview of *Zauderer*, but a "restricted speech" case under *Central Hudson*. "If the communication is neither misleading nor related to unlawful activity, the government's power is more circumscribed." *Central Hudson*, 447 U.S. at 564. The court has found that the speech at issue is neither misleading nor related to unlawful activity. Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) suppress Allstate's commercial speech rather than forcing it to make a disclosure for the purpose of correcting or avoiding a potential deception or misapprehension. For these reasons, the court must employ the *Central Hudson* analysis in analyzing the constitutionality of Tex. Occ. Code §§ 2306.006 (3), (4), (6) and (9). *Zauderer*, 471 U.S. at 651 n.14; *see also Central Hudson*, 447 U.S. at 564-66.

68. Allstate's ownership and operation of existing Sterling repair shops, at least to the extent they existed or were under construction as of April 15, 2003, is lawful under the act. Tex. Occ. Code § 2306.002(b). Therefore, the court's First Amendment analysis of the statute applies to Allstate and Sterling's continued ownership and operation of these 15 stores.

69. Defendants and Intervenors argue that the restrictions in Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) are merely incidental to a valid governmental restriction on conduct, relying on *Pittsburgh Press Co. v. Pittsburgh Commission on Human Relations,* 413 U.S. 376, 389 (1973) and *Ford,* 264 F.3d at 506. *Pittsburgh Press* and *Ford* both hold that any First Amendment interest is absent when the commercial activity itself is illegal, thus making the restrictions on speech merely incidental to a valid limitation on economic activity. 413 U.S. at 389; 264 F.3d at 506. However, The Fifth Circuit has confirmed that the intermediate scrutiny of the *Central Hudson* analysis is applicable to the regulation of speech related to lawful commercial activity, as is the case here. *Ford,* 264 F.3d at 506.

70. Therefore, Defendants and Intervenors' reliance on these cases is misplaced, as they are distinguishable from the instant case. Here, Allstate's ownership of the 15 Sterling autobody repair shops it currently operates in Texas is expressly made lawful under Tex. Occ. Code § 2306.002(b). Therefore, §§ 2306.006(3), (4), (6) and (9)'s regulation of commercial speech is not incidental to the regulation of unlawful commercial activity. *See Ford,* 264 F.3d at 506 (finding that restriction on plaintiff's ability to advertise motor

vehicles for sale was incidental to prohibition on sale of such vehicles, but stating that "[i]n contrast, if § 5.02C(e) prohibited advertising the sale of motor vehicles by licensed dealers, a commercial activity lawful in Texas, the regulation would invoke the protections of the First Amendment and be subjected to the intermediate scrutiny outlined in *Hudson*.").

71. Under *Central Hudson,* the court must determine whether (1) the disputed speech is false or misleading; (2) whether the state has a substantial interest in regulating the speech; (3) whether the restriction on speech directly advances the state interest involved; and (4) whether the state's interest could be equally well served by a more limited restriction on commercial speech. 447 U.S. at 566.

1. Whether the Speech is False or Misleading

72. Plaintiffs have satisfied the first prong of the *Central Hudson* test, in that nothing in the disputed commercial speech is false or misleading. Therefore, to regulate truthful and non-deceptive speech, Defendants and Intervenors bear the ultimate burden of proving that the state has a substantial interest, that the statute directly and materially advances this interest, and the regulation is narrowly drawn. *Bailey v. Morales,* 190 F.3d 320, 323 (5th Cir. 1999).

2. Legitimacy of State Interest

73. Defendants and Intervenors assert that Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) meet the second prong of the *Central Hudson* test because the state has a legitimate interest in consumer protection and the promotion of fair competition. *See Ohralik v. Ohio State Bar Assn.*, 436 U.S. 447, 460 (1978) (state

clearly has an interest in consumer protection); *Ford*, 264 F.3d at 503 (preventing vertically integrated companies from taking advantage of their incongruous market position and "'to prevent frauds, unfair practices, discrimination, impositions, and other abuses of our citizens' – are legitimate state interests"). The court agrees that both of these objectives are legitimate state interests, and therefore Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) meet the second element of the *Central Hudson* test.

3. Whether the Regulations Directly and Materially Advance the State's Asserted Interest

74. As stated above, it is Defendants' position that the challenged subsections of Tex. Occ. Code § 2306.006 accomplish the state's goals of consumer protection and the promotion of fair competition. The court disagrees, because Defendants have not shown that restricting truthful speech about the benefits of using a Sterling repair shop benefits consumers. *See Central Hudson*, 447 U.S. at 567 (suppression of advertising reduces the information available for consumer decisions and is contrary to the purpose of the First Amendment).

a. Protecting Consumers

75. Consumers benefit from more, rather than less, information. Attempting to control the outcome of the consumer decisions following such communications by restricting lawful commercial speech is not an appropriate way to advance a state interest in protecting consumers. *Thompson v. Western States Medical Center*, 535 U.S. 357, 374 (2002).

76. In its communications with customers, Allstate makes clear that they may use any body shop they wish. Specifically, the script Allstate uses when its customers call to report damage to their vehicles states that "you are always ***free to choose*** any repair shop of your choice and are under no obligation or requirement to use a shop we recommend..." However, Allstate goes on to provide *additional* information about the benefits of using Sterling, while also disclosing that Sterling is an affiliated company. The court sees no "consumer benefit" to restricting Allstate's ability to advertise and promote Sterling to its customers.

77. Whether or not consumers make better or worse choices when provided with such truthful, non-misleading information does not justify action by the state to interfere with or deprive consumers of their lawful options. *Allstate Ins. Co. v. Serio*, 2000 WL 554221, (S.D.N.Y. 2000), *question certified by* 261 F.3d 143 (2d Cir. 2001), *answered by* 746 N.Y.S.2d 416 (N.Y. 2002); *44 Liquormart*, 517 U.S. at 510.

78. If using a Sterling shop does, in reality, harm consumers, consumers may bring litigation against Sterling and/or Allstate to pursue their legal remedies. Additionally, consumers can refuse to use Sterling in the future. Finally, poor experiences with Sterling may also generate negative word of mouth that would keep some consumers from choosing a Sterling shop for their autobody repairs. Therefore, the court holds that preventing Allstate from speaking to customers about Sterling would merely steer business away from Sterling rather than protect consumers, who may or may not choose to use Sterling even after being informed of its

advantages, and who may have a good rather than bad experience if they do choose to use Sterling.

b. Promoting Fair Competition

79. Next, Defendants argue that Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) directly and materially advance the state's objective of promoting fair competition.

80. Early in this case, Defendants and Intervenors asserted that PRO shops should be featured in Allstate's speech in a manner that "levels the playing field" between Sterling and the PRO shops. Defendants and Intervenors have now re-worded this assertion, stating that Allstate must make recommendations "on a fair basis among all of the autobody repair shops that qualify under Allstate's chosen criteria for receiving a recommendation or referral."

81. The court disagrees that the speech restrictions in Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) will truly combat unfair competition. First, Allstate's speech promoting Sterling is simply advertising – a fundamental component of competition in most industries. The fact that Sterling may have "raised the bar" by claiming to provide additional and/or superior products and services should only spur further competition by the PRO and other independent autobody repair shops rather than inhibit it.

82. Further, although Defendants and Intervenors may contend that it is permissible to require Allstate, in its commercial speech, to promote equally all autobody repair shops "that qualify under Allstate's chosen criteria for receiving a recommendation or referral," language promoting

shops that have proven themselves to Allstate as good collision repairers (the PRO shops) only extends an advantage on a wider number of shops, not *all* shops in Texas equally. In Defendants and Intervenors' view, this advantage that they seek for the PRO shops is "unfair" when it only includes Sterling, but somehow evolves into "fair competition" when the circle of advantaged shops is widened to include the PRO shops, although non-PRO shops are still excluded.

83. Thus, Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) do not truly make competition equal for all autobody shops statewide. Rather, they only protect the interests of those shops who participate in Allstate's PRO program. Overall fair competition is not advanced by these speech restrictions. For these reasons, the court finds that Tex. Occ. Code §§ 2306.006 (3), (4), (6) and (9) do not materially and substantially advance the state interests of consumer protection and promoting fair competition.

4. Whether the Restriction on Commercial Speech is Narrowly Tailored to the State Interest Advanced

84. The restrictions on commercial speech imposed by Tex. Occ. Code §§ 2306.006 (3), (4), (6) and (9) are not narrowly tailored to meet the asserted objectives of consumer protection and promotion of fair competition. First, the restriction prohibiting the promotion of Sterling may deprive consumers of information that could be beneficial to them. Also, consumers already have the protection of Texas's anti-steering law. Finally, the restrictions of Tex. Occ. Code §§ 2306.006 (3), (4), (6) and (9) do not sufficiently promote the state's interest in fair competition, since they restore a competitive

advantage lost only by Allstate's PRO shops, not all autobody shops statewide.

a. Consumer Protection

85. A ban on Plaintiffs' speech promoting Sterling inhibits the dissemination of information that may benefit consumers and thus is not narrowly tailored to protect them.

86. Consumers are already protected by the Texas anti-steering statute, which prohibits insurers such as Allstate from requiring policyholders to use a certain autobody shop for their repairs to be covered. *See* Tex. Ins. Code § 5.07-1(b)(2); *see also Allstate Ins. Co. v. State of South Dakota*, 871 F. Supp. 355, 358 (D.S.D. 1994) (restrictions on referral to preferred auto glass replacement services not narrowly tailored where anti-steering statute was in place preventing insurers from requiring policyholders to use a particular auto glass repair or replacement business). Allstate's script makes it clear to consumers that they may use any car repair facility they choose; however, Allstate is promoting Sterling, an affiliated company.

87. Requiring disclosures regarding Allstate's ownership of Sterling (which the court notes that Allstate is already making to its policyholders) would have appropriately served the state's stated interests in consumer protection, and functioned as a less restrictive mechanism than banning Allstate from recommending Sterling without providing an equivalent recommendation of other independent repair facilities.

b. Promotion of Fair Competition

88. Additionally, Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) are not narrowly tailored to serve the

state's interest in promoting fair competition. The requirements of the statute that essentially force Allstate to promote its PRO shops on an equal footing with Sterling shops merely allows the PRO shops to regain a competitive advantage that may have been diminished with Allstate's acquisition of Sterling.

89. There has been no showing that the restoration of this advantage for the PRO shops through H.B. 1131 would have a positive effect on competition overall, as those shops not included in the PRO program would not be blessed with any increased ability to compete.

90. Since Sterling holds only about a 2% share of the Texas autobody repair market, this court doubts that Sterling's presence in the Texas marketplace, and privileged position vis-à-vis other body shops to which Allstate may have referred its customers, have resulted in unfair competition.

91. Finally, an additional benefit of the anti-steering law already in place is that it protects competition by giving Texas auto policyholders the freedom to choose any repair facility for their collision repairs. Allstate follows the anti-steering law and makes it clear to customers that they are "free to choose" their own repair shop, both in their telephone scripts and on the company's website.

92. Because the record does not show that consumers lack sufficient information about their repair rights and options, or that Allstate's promotion of Sterling has a negative effect on competition, the court finds that the restrictions imposed by subsections (3), (4), (6) and (9) of Tex. Occ. Code § 2306.006, which restrict Plaintiffs' speech about Sterling's products and services are not narrowly tailored, meaning that

they are more extensive than necessary to serve the interests claimed by the state.

93. The state can find (and has found, in the case of the anti-steering statute) less restrictive means of protecting consumers and fair competition in the marketplace. For the above-stated reasons, the court finds that Plaintiffs have established that subsections (3), (4), (6) and (9) of Tex. Occ. Code § 2306.006 do not survive the constitutional scrutiny of *Central Hudson,* because the restrictions imposed by H.B. 1131 on Allstate's truthful commercial speech do not directly advance the state's interests in consumer protection and promotion of fair competition, and they are not narrowly tailored (or no more restrictive than necessary) to promote these asserted state interests. The court finds that Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) violate Plaintiffs' First Amendment right to free commercial speech and are unconstitutional.

c. Severability

94. Because the court has upheld H.B. 1131's overall prohibition on insurer ownership of repair shops under the dormant Commerce Clause, but has invalidated Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) as unconstitutional under the First Amendment, the court must determine whether the invalid portions of the statute are severable.

95. H.B. 1131 contains no express severability clause. In the absence of an express severability clause, the test for severability turns on the intent of the state legislature. *Assn. of Texas Professional Educators v. Kirby,* 788 S.W.2d 827, 830 (Tex. 1990); Tex. Govt. Code § 312.013(b). Where part of a statute is unconstitutional, valid portions of the statute will still stand if they are so "clearly independent" of the

unconstitutional provisions that the Legislature would have passed them absent the unconstitutional provisions. *Kirby,* 788 S.W.2d at 830. Otherwise, if all of the provisions of the statute are so connected that it is apparent that the Legislature would not have passed the act, except as a whole, then the entire statute must fall. *Id.* at 830-31.

96. The Texas Government Code also states that if a provision of a statute is held invalid, the invalidity does not affect other provisions of the statute that can be given effect without the invalid provision, and to this end the provisions of the statute are severable. Tex. Govt. Code §§ 311.032(c), 312.013(a).

97. Here, the other sections of H.B. 1131 can still be given effect even if the speech restrictions contained in Tex. Occ. Code §§ 2306.006 (3), (4), (6) and (9) are held invalid and severed. These restrictions apply to 15 Sterling stores which were grandfathered under Tex. Occ. Code § 2306.002(b). Under that section of the statute, Allstate will still be legally permitted to continue owning those 15 Sterling locations, whether or not the speech restrictions in section 2306.006(3), (4), (6) and (9) continue to apply.

98. Even though the restrictions in Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9) are constitutionally invalid, H.B. 1131's prohibition on insurer ownership of collision repair shops, if standing by itself, would still be valid. The validity of H.B. 1131's overall prohibition of ownership does not depend upon the speech restrictions. These provisions are clearly independent of each other, and the court believes that the Texas legislature would still have passed H.B. 1131 had the speech restrictions been omitted. The court finds that section 2306.006(3), (4), (6) and (9) are severable from the remainder of the statute.

d. Supremacy Clause and Lanham Act Preemption

99. Allstate and Sterling have alternatively argued that Tex. Occ. Code § 2306.006(6), which regulates the use of Allstate's name, trademark, tradename, brand or logo is unconstitutional under the Supremacy Clause and preempted by the Lanham Act, 15 U.S.C. § 1127. Because the court has determined that this provision of H.B. 1131 is unconstitutional under the First Amendment, it does not reach these arguments and makes no ruling thereupon.

e. Constitutional Estoppel

100. Defendants and Intervenors contend that because Allstate and Sterling have received the benefit of H.B. 1131's grandfather clause, which permits them to continue operating any Sterling stores that were open or under construction as of April 15, 2003 (*see* Tex. Occ. Code § 2306.002(b)), they cannot challenge H.B. 1131 on constitutional grounds. According to Defendants and Intervenors, H.B. 1131 was compromise legislation that provided a benefit to insurance companies such as Allstate who had acquired an interest in autobody repair shops, permitting them to avoid divestiture. Defendants and Intervenors argue that Allstate and Sterling voluntarily accepted the benefit provided by Tex. Occ. Code § 2306.002(b), and therefore are estopped from bringing a constitutional challenge against the statute.

101. The doctrine of constitutional estoppel provides that "one may not retain the benefits of the Act while attacking the constitutionality of one of its important conditions." *Fahey v. Mallonee*, 332 U.S. 245, 255 (1947). However, this rule has not been strictly

applied, and has rather been applied on a case-by-case basis. *Alliant Energy Corp. v. Bie,* 330 F.3d 904, 909 (7th Cir. 2003), *citing Kadrmas v. Dickinson Pub. Sch.,* 487 U.S. 450, 456-57 (1988).

102. In cases where constitutional estoppel has been applied to preclude a constitutional challenge to a statute, courts have consistently held that the party being estopped "owed its existence" to the benefits provided by the challenged statute. *See Fahey,* 332 U.S. at 256 (appropriate to apply constitutional estoppel where savings and loan association created under the challenged act utilized the act itself to "gain advantages of corporate existence"); *Medical Waste Assoc. Ltd. Partnership v. Mayor and City Council of Baltimore,* 966 F.2d 148, 152 (4th Cir. 1992) (plaintiff's medical waste incinerator would not have existed if not for passage of ordinance which plaintiff actively pursued). However, courts have also held that parties who "are not the creatures of any statute" are not forbidden to challenge a statute simply because they have derived some benefit from it. *Kadrmas,* 487 U.S. at 456-57; *S.J. Groves & Sons Co. v. Fulton County,* 920 F.2d 752, 769 (11th Cir. 1991).

103. Although Allstate and Sterling have availed themselves of the benefits of Tex. Occ. Code § 2306.002(b), they are not "the creatures" of that statute and do not owe their existence to it. Both Allstate and Sterling enjoyed their corporate existence prior to the passage of H.B. 1131, and presumably that existence will continue whether or not H.B. 1131 is either completely upheld or, as the court has determined here, partially invalidated. Furthermore, even though the grandfather clause benefits Allstate and Sterling somewhat, the

remainder of H.B. 1131 is highly disadvantageous to them. The record is clear that unlike the plaintiffs in *Fahey* and *Medical Waste,* Allstate and Sterling fought against, rather than supported, the passage of H.B. 1131. The court is not convinced that the small benefit Allstate and Sterling received at the end of the legislative process justifies the application of constitutional estoppel here. The court holds that Allstate and Sterling are not constitutionally estopped from challenging H.B. 1131.

f. 42 U.S.C. § 1983

104. Tex. Occ. Code § 2306 does not authorize a state agency to enforce its provisions; rather, it creates a private right of action for persons aggrieved by a violation of the statute. Tex. Occ. Code § 2306.009.

105. 42 U.S.C. § 1983 provides a remedy for deprivations of rights secured by the Constitution and laws of the United States, when that deprivation occurs 'under color of any statute, ordinance, regulation, custom or usage, or any State or Territory .."*Lugar v. Edmondson Oil Co.,* 457 U.S. 922, 924 (1982).

106. Allstate and Sterling must show that Defendants Abbott and Strayhorn (who are sued in their official capacities as officers of the State of Texas) acted under color of law. *Adickes v. S.H. Kress & Co.,* 398 U.S. 144, 150 (1970). Acting under color of state law is defined as the "[m]isuse of power possessed by virtue of state law and made possible only because the wrongdoer is clothed with authority of state law." *Monroe v. Pape,* 365 U.S. 167, 184 (1961). Unexercised authority under state law is not action under color of state law. *Brown v. Chaffee,* 612 F.2d 497, 501 (10th Cir. 1979). It is undisputed that Abbott or Strayhorn have not taken any action

against Allstate and Sterling to enforce H.B. 1131. Accordingly, Allstate and Sterling have not established a violation of section 1983.

III. Conclusion

For the foregoing reasons, the court concludes that H.B. 1131 does not violate the dormant Commerce Clause and is constitutional, with the exception of the speech restrictions found in Tex. Occ. Code §§ 2306.006(3), (4), (6) and (9), which the court has concluded do violate the First Amendment to the United States Constitution. The court will enter judgment consistent with these findings of fact and conclusions of law by separate document.

SO ORDERED.

Signed March 9th , 2006.

s/Ed Kinkeade

ED KINKEADE

UNITED STATES
DISTRICT JUDGE

No. 06-10500

ALLSTATE INSURANCE COMPANY and
STERLING COLLISION CENTERS, INC.

Plaintiffs-Appellants/Cross-Appellees,

v.

GREG ABBOTT, in his official capacity as Attorney General of Texas, and SUSAN COMBS, in her official capacity as Texas Comptroller of Public Accounts,

Defendants-Appellees/Cross-Appellants

v.

AUTOMOTIVE SERVICE ASSOCIATIO[illegible] and
CONSUMER CHOICE FOR AUTOBODY REPAIR,

Intervenors-Appellees/Cross-Appellants

Appeal from the United States District Court for the Northern District of Texas.

ON PETITIONS FOR REHEARING
AND REHEARING EN BANC

(Opinion 8/1/07, 5 Cir., _____, _____F.3d _____)
Before KING, DAVIS and BARKSDALE, Circuit Judges.

PER CURIAM:

(X) The Petitions for Rehearing are DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on Rehearing En Banc, (FED. R. APP. P. and 5th CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) The Petitions for Rehearing are DENIED and the court having been polled at the re uest of one of the members of the court and a majority of the judges who are in regular active service and not disqualified not having voted in favor, (FED. R. APP. P. and 5th CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) A member of the court in active service having requested a poll on the reconsiderations of this cause en banc, and a majority of the judges in active service and not disqualified not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

_____

United States Circuit Judge

*Judge Clement did not participate in the consideration of the rehearing en banc.

OCCUPATIONS CODE

TITLE 14. REGULATION OF MOTOR VEHICLES AND TRANSPORTATION

SUBTITLE A. REGULATIONS RELATED TO MOTOR VEHICLES

CHAPTER 2307. INSURER INTERESTS IN REPAIR FACILITIES

Tex. Occ. Code § 2307.001 (2007)

§ 2307.001. Definitions

In this chapter:

(1) "Arm's length transaction" means the standard of conduct under which two parties having substantially equal bargaining power, each acting in its own interest, would negotiate or carry out a particular transaction.

(2) "Claims center" means a location designated by an insurer where a claims adjuster, employee, or agent of the insurer performs an initial damage estimate on a vehicle under the terms of an insurance policy.

(3) "Favored facility agreement" means an agreement between an insurer and a repair facility under which the in-surer agrees to recommend, directly or indirectly, to its policyholders or other beneficiaries under the insurer's policies, that the policyholder or other beneficiary obtain repairs at that repair facility or in any other way agrees to influence its policyholders or other beneficiaries under the insurer's policies to obtain repairs at that repair facility.

(4) "Insurer" means an insurer authorized by the Texas Department of Insurance to write motor vehicle insurance in this state, including a county mutual insurance company, a Lloyd's plan, and a reciprocal or interinsurance exchange if that insurer owns an interest in a repair facility in this state. The term includes an entity that is an affiliate of an insurer as described by Section 823.003, Insurance Code.

(5) "Repair facility" has the meaning assigned by Section 2304.001.

(6) "Support services" means basic services, provided nonspecifically, that are provided internally and to each affiliate or subsidiary, by an insurer, its parent company, or a separate affiliate created to provide basic corporate support. The term does not include a service related to the operation of a repair facility if that service would have no value, or minimal value to any other type of business.

(7) "Tied repair facility" means a repair facility in which an insurer owns an interest.

Tex. Occ. Code § 2307.002 (2007)

§ 2307.002. Insurer Interests

(a) Except as provided by this section, an insurer may not own or acquire an interest in a repair facility.

(b) An insurer that owns an interest in a tied repair facility that was open for business, or on which construction had commenced, on April 15, 2003, may maintain that ownership interest and may operate that facility.

(c) An insurer may relocate a tied repair facility described by Subsection (b), but may not obtain an ownership interest in any additional facility not described by Subsection (b).

(d) Subsections (b) and (c) are applicable to an insurer only if the insurer and its tied repair facility are otherwise in compliance with this chapter.

Tex. Occ. Code § 2307.003 (2007)

§ 2307.003. Favored Facility Agreement Presumed

An insurer is presumed to have a favored facility agreement with a repair facility in which it owns an interest.

Tex. Occ. Code § 2307.004 (2007)

§ 2307.004. Contractual Conditions

(a) An insurer that owns an interest in a repair facility may use only one favored facility agreement.

(b) Except as otherwise provided by this subsection, the terms under which the insurer enters into a favored facility agreement must be identical for all repair facilities, including a tied repair facility. An insurer may vary the terms as necessary to implement technical differences required by geographical factors or other legitimate business factors.

(c) Except as provided by Subsection (d), an insurer may not cancel a favored facility agreement until the expiration of the 30th day after the date on which the insurer provides notice to the repair facility of the insurer's intent to cancel the agreement. The insurer shall include with the notice a statement explaining the reason for the cancellation of the agreement.

(d) An insurer may summarily cancel a favored facility agreement with a repair facility if the insurer, a policy-holder of the insurer, or another beneficiary under the insurer's policy establishes reasonable grounds to believe that the repair facility is fraudulent in its dealings with the insurer or the policyholder or other beneficiaries under the insurer's policy.

Tex. Occ. Code § 2307.005 (2007)

§ 2307.005. Notice

(a) An insurer that owns an interest in a repair facility shall post the following notice in each of its tied repair facilities:

"THIS REPAIR FACILITY IS OWNED IN WHOLE OR IN PART BY (NAME OF INSURER). YOU ARE HEREBY NOTIFIED THAT YOU ARE ENTITLED TO SEEK REPAIRS AT ANY REPAIR FACILITY OF YOUR CHOICE."

(b) The notice required by Subsection (a) must be posted prominently in a location in which it is likely to be seen and read by a customer of the repair facility.

Tex. Occ. Code § 2307.006 (2007)

§ 2307.006. Prohibitions

An insurer may not:

(1) condition the provision of a product, service, insurance policy renewal, pricing, or other benefit on the purchase of any good or service from its tied repair facilities;

(2) share information with its tied repair facilities that is not made available on identical terms and conditions to other repair facilities with which the

insurer has entered into a favored facility agreement;

(3) engage in a joint marketing program with its tied repair facilities;

(4) provide its tied repair facilities a recommendation, referral, description, advantage, or access to its policyholders or other beneficiaries under its insurance policies that is not provided on identical terms to other repair facilities with which the insurer has entered into a favored facility agreement;

(5) provide a tied repair facility access to the insurer's products or services on terms and conditions different from those under which the insurer provides access to the same products or services to another repair facility with which the insurer has entered into a favored facility agreement;

(6) allow a tied repair facility to use the insurer's name, trademark, tradename, brand, or logo in a manner different than that allowed for any other favored facility;

(7) subsidize the business activities or operating expenses of a tied repair facility;

(8) directly or indirectly require a policyholder of the insurer or other beneficiary under the insurer's policy to obtain a damage estimate on a vehicle covered by the insurance policy at a tied repair facility;

(9) authorize or allow a person representing the insurer, whether an employee or an independent contractor, to recommend to a policyholder or other beneficiary under the insurance policy that the

policyholder or other beneficiary obtain repairs at a tied repair facility, except to the same extent that the person recommends other repair facilities with whom the insurer has entered into a favored facility agreement;

(10) require a policyholder or beneficiary to use a claims center located on the premises of a tied repair facility;

(11) enter into a favored facility agreement exclusively with its tied repair facilities;

(12) retaliate or discriminate against a person who:

(A) files an action as provided by this chapter; or

(B) assists or participates in any manner in an investigation, judicial proceeding, or other action brought or maintained as provided by this chapter; or

(13) include earnings or losses of a tied repair facility in a rate filing made under Chapter 5, Insurance Code.

Tex. Occ. Code § 2307.007 (2007)

§ 2307.007. Conflict of Interest Prohibited

Except as otherwise provided by this chapter, an agreement between an insurer and its tied repair facility must be negotiated and executed as an arm's length transaction.

Tex. Occ. Code § 2307.008 (2007)

§ 2307.008. Support Services

(a) Notwithstanding this chapter, and except as provided by Subsection (b), an insurer may provide support services to its tied repair facilities if those services:

(1) are priced at a level that is fair and reasonable to both the insurer and the tied repair facility; and

(2) do not directly or indirectly confer a competitive advantage to the tied repair facility.

(b) Notwithstanding Subsection (a), an agreement by an insurer to provide support services to its tied repair facility may not create the potential for confusion among the policyholders of the insurer, other beneficiaries of an insurance policy issued by the insurer, or other parties

Tex. Occ. Code § 2307.009 (2007)

§ 2307.009. Action to Compel Compliance; Disciplinary Action

(a) A person, including a repair facility, aggrieved by a violation of this chapter by an insurer may bring an action for injunctive or other appropriate relief to compel the insurer to comply with this chapter.

(b) In an action brought under this section, in addition to other appropriate relief, the court may impose a civil penalty as provided by this section.

(c) A civil penalty imposed under this section may not be less than $1,000 or more than $5,000 per violation. Each day during which a violation occurs is a separate violation.

(d) The amount of a civil penalty under this section is based on the seriousness of the violation, and must reflect the following factors:

(1) the nature, circumstances, extent, and gravity of the act or omission that constitutes the violation;

(2) the economic harm caused by the violation;

(3) the history of previous violations;

(4) the need to deter future violations by the person charged with a violation;

(5) efforts, if any, made to correct the violation; and

(6) any other factors the court considers appropriate to implement the remedial intent of this chapter.

(e) A civil penalty collected under this section shall be sent to the comptroller for deposit in the general revenue fund.

(f) A plaintiff who prevails in an action under this section is entitled to recover reasonable attorney's fees and court costs.

(g) If a court finds that an action brought under this section was groundless, brought in bad faith, or brought for the purpose of harassment, the court may award reasonable attorney's fees to the prevailing defendant.

Tex. Occ. Code § 2307.010 (2007)

§ 2307.010. Antitrust Enforcement

This chapter does not confer immunity from an antitrust law of this state or the United States. A sanction or penalty imposed in an action brought under this chapter is in addition to other relief granted on the basis of the violation of an antitrust law of this state or the United States.

Tex. Occ. Code § 2307.011 (2007)

§ 2307.011. Exclusivity

Unless otherwise specifically provided by this chapter, this chapter provides the exclusive authority and rules applicable to the regulation of the relations between an insurer and a tied repair facility.

THE HOUSE COMMITTEE ON LICENSING &
ADMINISTRATIVE PROCEDURES
78TH LEGISLATURE
RE: HB 1131
MARCH 6, 2003

P R O C E E D I N G S

MR. CHAIRMAN: Members, the Chair at this time will lay out House Bill 947 -- 1131 and ask Chairman Flores to explain the bill.

REP. FLORES: Thank you, Mr. Chair, members of the committee. Before you will be House Bill 1131, which not only in my part of the woods, but all over the State of Texas, has become a tremendous problem. What this seeks is to remedy a situation that is occurring in a lot of the major metropolitan areas, which is -- and it's spreading, and it's allowing insurance companies, which are purchasing and building body shops, to compete with those run by our local independent folks back home in our communities.

By eliminating the only independent voice that the car owner has in the repair process, that of an independent body shop owner, insurance companies control both the money to pay for damage to a claimant's car and the person who will decide what repairs need to be made to get the car out of the door.

called me.

REP. DRIVER: Do you know if there's any plans for any more stores?

MS. MAZANEC: I think there's growth potential in Texas. It is a huge market. And because the ability for us to concentrate in areas where there are -- where we make little impact, but still provide customer choice, that is something that is good. So, I would anticipate growth because this is a huge Allstate market.

REP. DRIVER: Right. And that is part of what concerns me is the fact that it would be Allstate competing with the collision center or Herb's or somebody like that. To me, that doesn't seem to be like a fair game. We use the words "level playing field" up here all the time. It makes me sick. But that, to me, sounds like that could be a very unequal situation.

Let me ask one other thing. Preferred providers, if Allstate -- I saw somebody out here on the second row when somebody asked about, you know, the preferred providers. Do you know what other companies use Sterling as a preferred provider for lack of a better term? Any of the other insurance companies?

MS. MAZANEC: Not to my knowledge. We're not a preferred provider for any other company to my knowledge in Dallas.

REP. DRIVER: Were you ever?

MS. MAZANEC: Not in the Dallas market, no, because we already -- when we built our stores -- they're all new stores. When we built those stores,

they were actually new acquisitions and Allstate had already purchased Sterling.

REP. DRIVER: So, you built stores after Allstate purchased y'all?

MS. MAZANEC: It is a new market.

REP. DRIVER: Y'all weren't in the Dallas market at all?

MS. MAZANEC: No.

REP. DRIVER: Why would insurance companies now provide you with that preferred provided status if you, in fact, were capable of it?

MR. HAMMOND: Yes, sir.

REP. HOMER: There's no -- we can't argue that Allstate has all parts of that. That's not -- but that's where I was -- I was just thinking and that's where I'm having a little trouble with.

MR. HAMMOND: I just think that --

REP. HOMER: Although, again, I don't -- I'm not here to toot Allstate's horn, again.

MR. HAMMOND: Right.

REP. HOMER: Because I'm a small businessman. Hey, there's nothing that angers me more than when the big guy comes in and just -- because I've got more money than you do, I run you out of town and that. But I just -- that's what came to mind. It's kind of the Wal-Mart scenario.

MR. HAMMOND: Well, I guess it just comes to mind that there's plenty of laws on the books, many of which aren't enforced and many of which could be enforced, but not necessitate additional laws.

MR. CHAIRMAN: Are there other questions for Mr.

continue to do business. Allstate, you can continue to do business with Sterling. But if you do, you just can't make any money off that transaction.

MR. RODRIGUEZ: If they are also as good or better than we are, they shouldn't be worried about our competition. We are competing in the market and the last indications are we was a pro shop and we had -- when I start with Sterling before Allstate came into the picture. We was a pro shop and we had 13 -- 13 to 14 insurers. I can remember, it was four years ago. And we give up 13 in exchange for one. So, the competition has 13 insurers we leave and there is many, many more insurers.

REP. WISE: Well, and that --

MR. RODRIGUEZ: So, where is the unfair competition?

REP. WISE: See, I disagree with you. The vast majority of the auto market in this state is controlled by only three companies. So, if one of those three companies is directing its covered premium holders to one company, well, then what do you think that does to the mom-and-pops? Obviously, it cannot be a satisfactory result for those folks. It will drown them out.

MR. CHAIRMAN: Are there other questions for Mr. Rodriguez? Mr. Driver?

REP. DRIVER: I just want to say I like a guy that says that we've only got 94 percent satisfaction, but we're trying to get better.

(Applause.)

MR. CHAIRMAN: That's the American way. Thank you for your testimony. Tell me again, what do you do for Sterling so we can put it down.

MR. RODRIGUEZ: I'm just an auto body technician.

MR. CHAIRMAN: Okay.

MR. RODRIGUEZ: And I have only 27 years experience. Thank you.

MR. CHAIRMAN: Sounds pretty good. Mr. Franco Carbajal. Mr. Carbajal, state your name and who you represent and do you have some kind of a title? I think

like a bit of -- if an insurer owns a facility there, they have to post something to identify -- or to make people aware of the fact that it is owned by an insurance company. Is that right, Senator Carona?

SENATOR CARONA: That's correct. On page four, yes, sir, at the top.

MR. CHAIRMAN: Other questions?

(No response.)

MR. VANDERGRIFT: Thank you for your time.

MR. CHAIRMAN: Thank you. I went to school at UTA and was right down the street from you all for a number of years.

MR. VANDERGRIFT: That's great. Thank you very much.

MR. CHAIRMAN: Thank you.

SENATOR CARONA: One of the most significant changes, Mr. Chairman and Senator Van de Putte, is the fact that in this substitute, we do not require divestiture. That was one of the areas -- though it passed overwhelmingly in the house in that form and the Senate co-sponsored it in that form, that was an area of some concern and certainly by the insurance companies that have interest or would like to have interest. But we took care of that

and there's no longer any mandate of that in the bill. That was a significant concession.

I think the most significant thing we've tried to do here is, just as you were asking a moment ago, Senator, just make sure that -- in the shops that the insurance companies actually own versus the shops they have special arrangements with, that the terms be the same so that we don't let those actual shops owned by the insurance companies have any kind of competitive advantage in a region. And that's been one of the arguments that's been made and something I think you'll hear more about here in a few minutes.

SENATOR VAN DE PUTTE: Thank you. And let me tell you, Senator Carona, I appreciate you bringing this up. I was one of those folks who were with you on it and I think if -- my concern was if there was all divestiture, then that meant nobody would own any part of it. I think the question for me now is not so much the non-tied or ownership facilities versus the smaller facilities or ones that aren't, but the — maybe the competitive disadvantage of one insurance company versus